Supreme Court, U.S.
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In The Supreme Court of the United States

THANE INTERNATIONAL, INC., ET AL.,

Petitioners,

v.

JOSEPH J. MILKOWSKI, ON BEHALF OF HIMSELF AND ALL OTHERS SIMILARLY SITUATED,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Did the court of appeals exceed its authority under Federal Rule of Civil Procedure 52(a) in substituting its own findings of fact for those of a trial court regarding the existence and materiality of an alleged misrepresentation in a prospectus?

2. In an action for money damages, can a security's price be irrelevant to a determination of materiality?

PARTIES TO THE PROCEEDING

Petitioners Thane International, Inc., William F. Hay, Denise DuBarry-Hay, Kevin McKeon and Mark Taylor were defendants in the district court and appellees in the court of appeals.

Respondent Joseph J. Milkowski ("Milkowski"), both individually and on behalf of all others similarly situated, is currently the lead plaintiff in this action. Milkowski was substituted for the previous lead plaintiff, Howard Miller.

CORPORATE DISCLOSURE STATEMENT

Pursuant to Rule 29.6 of this Court, petitioners Thane International, Inc., William F. Hay, Denise DuBarry-Hay, Kevin McKeon and Mark Taylor state that Direct Marketing Holdings, Inc., a privately-held Delaware corporation, is the parent company of Thane International, Inc. and that no publicly held corporation owns 10% or more of the stock of Thane International, Inc.

TABLE OF CONTENTS

	Page
OPINIONS BELOW	1
STATEMENT OF JURISDICTION	1
STATUTORY PROVISIONS INVOLVED	2
PRELIMINARY STATEMENT	2
STATEMENT OF THE CASE	3
A. Factual Background	5
1. The Thane-Reliant Merger	5
2. Alleged Misrepresentations	7
3. Post-Merger Events	8
B. Proceedings Before The District Court	9
C. The Ninth Circuit Opinions	13
REASONS FOR GRANTING THE PETITION	15
I. The Ninth Circuit's Application Of Rule 52(a) Conflicts With That Of Other Circuits And With Prior Holdings Of This Court	15
A. The First, Fourth, Fifth, Seventh, Ninth And Eleventh Circuits Are Split Over The Proper Application Of Rule 52(a)	15
B. Consistent Application Of Rule 52(a) Promotes The Legitimacy Of Bench Trials And Judicial Economy	23

TABLE OF CONTENTS – Continued

Page

C. The Ninth Circuit's Review Of Materiality In This Case Conflicts With This Court's Decision In *Anderson* 25

II. The Ninth Circuit's Unsupported Holding As To Materiality Creates A Circuit Split, Conflicts With Prior Holdings Of This Court, And Is Inconsistent With Modern Finance Theory 28

A. The Ninth And Second Circuits Are Split Over The Ability To Refer To Price Information In Inefficient Markets To Determine Materiality..... 28

B. The Ninth Circuit's Opinion Conflicts With Modern Finance Theory And Common Sense 32

C. The Ninth Circuit's Opinion Exacerbates A Pre-Existing Circuit Split Concerning The Relationship Between Price And Materiality Under The Efficient Market Theory..... 34

CONCLUSION 40

APPENDICES

Appendix A – Amended Opinion of the United States Court of Appeals for the Ninth Circuit on Petition for Rehearing, dated March 18, 2008.....1a

TABLE OF CONTENTS – Continued

Page

Appendix B – Opinion of the United States Court of Appeals for the Ninth Circuit, filed November 26, 2007 ..... 31a

Appendix C – Judgment of the United States District Court for the Central District of California, filed June 10, 2005 ..... 59a

Appendix D – Memorandum of Decision of the United States District Court for the Central District of California, dated June 2, 2005 ..... 62a

Appendix E – Final Pretrial Conference Order of United States District Court for the Central District of California, filed March 28, 2005 ..... 95a

Appendix F – Order of the United States District Court for the Central District of California on Motions for Summary Judgment, dated March 3, 2005 ..... 139a

Appendix G – Order of the United States District Court for the Central District of California on Motions to Strike Experts' Reports 168a

Appendix H – Section 12 of the Securities Act of 1933, 15 U.S.C. § 77*l*, and Section 15 of the Securities Act of 1933, 15 U.S.C. § 77o 189a

Appendix I – Trial Declaration of Plaintiffs' Expert Candace L. Preston 192a

Appendix J – Trial Declaration of Defendants' Expert Bradford Cornell 217a

TABLE OF CONTENTS – Continued

Page

Appendix K – Trial Exhibit 44, Expert's Report of Bradford Cornell, including Exhibit 13 to the Report.....262a

Appendix L – Trial Exhibit 188-D (Thane International vs. Value Weighted Peer Group and NASDAQ Composite Indices, May 24, 2002 – June 24, 2002).....297a

Appendix M – Trial Exhibit 189-D (Thane International vs. Value Weighted Peer Group and NASDAQ Composite Indices, June 28, 2002 – August 13, 2002).....299a

Appendix N – Trial Exhibit 190-D (Thane's Stock Price Decline After the August 14, 2002 Earnings Announcement was in Proportion to the Announced Decrease in Earnings Per Share).....301a

Appendix O – Trial Exhibit 191-D (According To The Authorities Cited by Plaintiffs' Expert, Average Quotation Spreads Only Changed by $0.057 When Companies Moved to the NMS from NASDAQ).....303a

Appendix P – Trial Exhibit 192-D (According to the Authorities Cited by Plaintiffs' Expert, Average Percentage Spreads Only Changed by 0.782% When Companies Moved to the NMS from NASDAQ).....305a

TABLE OF AUTHORITIES

Page

FEDERAL CASES

Affiliated Ute Citizens of Utah v. United States,
406 U.S. 128 (1972) 3, 30, 31

Akerman v. Oryx Commc'ns, Inc.,
609 F. Supp. 363 (S.D.N.Y. 1984), *aff'd*,
810 F.2d 336 (2d Cir. 1987) 28, 29, 30

Alexander Proudfoot Co. World Headquarters v. Thayer,
877 F.2d 912 (11th Cir. 1989) 19

Anderson v. City of Bessemer,
470 U.S. 564 (1985) 3, 17, 19, 20, 25, 26, 28

In re Apollo Group, Inc. Sec. Litig.,
509 F. Supp. 2d 837 (D. Ariz. 2007) 39

In re Apollo Group, Inc. Sec. Litig.,
2008 WL 410625 (D. Ariz. Feb. 13, 2008) 39

Arrington v. Merrill Lynch, Pierce, Fenner & Smith, Inc.,
651 F.2d 615 (9th Cir. 1981) 25

Basic, Inc. v. Levinson,
485 U.S. 224 (1988) 3, 30, 31, 36, 37

Bose Corp. v. Consumers Union of United States, Inc.,
466 U.S. 485 (1984) 13, 16

In re Burlington Coat Factory Sec. Litig.,
114 F.3d 1410 (3d Cir. 1997) 35, 36

City of Monroe Employees Ret. Sys. v. Bridgestone Corp.,
399 F.3d 651 (6th Cir. 2005) 36

TABLE OF AUTHORITIES – Continued

Page

D & S Redi-Mix v. Sierra Redi-Mix and Contracting Co., 692 F.2d 1245 (9th Cir. 1982) 27

Daubert v. Merrell Dow Pharms., Inc., 509 U.S. 579 (1993) 9, 10

Easley v. Cromartie, 532 U.S. 234 (2001) 20, 21, 26

Eckstein v. Balcor Film Investors, 8 F.3d 1121 (7th Cir. 1993) 32

Hall v. National Gypsum Co., 105 F.3d 225 (5th Cir. 1997) 17

Jennings v. Tinley Park Cmty. Consol. Sch. Dist. No. 146, 864 F.2d 1368 (7th Cir. 1988) 17

Lucas v. Florida Power & Light Co., 765 F.2d 1039 (11th Cir. 1985) 25

McFarland v. T.E. Mercer Trucking Co., 781 F.2d 1146 (5th Cir. 1986) 17, 18, 20

Missouri Pac. R.R. Co. v. Railroad Comm'n of Texas, 948 F.2d 179 (5th Cir. 1991) 18, 20

Nash v. Farmers New World Life Ins. Co., 570 F.2d 558 (6th Cir. 1978) 25

Nathenson v. Zonagen, Inc., 267 F.3d 400 (5th Cir. 2001) 35

TABLE OF AUTHORITIES – Continued

Page

No. 84 Employer-Teamster Joint Council Pension Trust Fund v. America West Holding Corp., 320 F.3d 920 (9th Cir. 2003) 35, 37, 38

Oran v. Stafford, 226 F.3d 275 (3d Cir. 2000).....35, 36

Oscar Private Equity Invs. v. Allegiance Telecom, Inc., 487 F.3d 261 (5th Cir. 2007) 34

Padilla-Mangual v. Pavia Hosp., 516 F.3d 29 (1st Cir. 2008).....18

Planned Parenthood Ass'n/Chicago Area v. Chicago Transit Auth., 767 F.2d 1225 (7th Cir. 1985) 17, 20

In re Polymedica Sec. Litig., 432 F.3d 1 (1st Cir. 2005).....35, 36

Rochez Bros., Inc. v. Rhoades, 491 F.2d 402 (3d Cir. 1974).....25

SEC v. Mize, 615 F.2d 1046 (5th Cir. 1980) 25

TSC Indus. v. Northway, Inc., 426 U.S. 438 (1976).....3, 25, 27, 30, 31

In re Take-Two Interactive Sec. Litig., ___ F. Supp. 2d ___, 2008 WL 1757823 (S.D.N.Y. Apr. 16, 2008) 36

TABLE OF AUTHORITIES – Continued

Page

Toombs v. Leone,
777 F.2d 465 (9th Cir. 1985) 25

United States v. Stevenson,
396 F.3d 538 (4th Cir. 2005) 18

FEDERAL STATUTES AND RULES

15 U.S.C. § 77o.....2, 9

15 U.S.C. § 77*l* 2, 4, 9, 11

15 U.S.C. § 77v 9

28 U.S.C. § 1254(1).....1

28 U.S.C. § 1331 9

Fed. R. Civ. P. 52.....*passim*

MISCELLANEOUS

Bryan L. Adamson, *Federal Rule of Civil Procedure 52(a) as an Ideological Weapon?*, 34 Fla. St. U. L. Rev. 1025 (2007).....19, 22

Kevin Clermont & Theodore Eisenberg, *Appeal from Jury or Judge Trial: Defendant's Advantage*, 3 Am. Law & Econ. Rev. 125 (2001).....24

Theodore Eisenberg, *Appeal Rates and Outcomes in Tried and Nontried Cases: Further Exploration of Anti-Plaintiff Appellate Outcomes*, 1 J. Empirical Legal Stud. 659 (2004).....24

Eugene F. Fama, *Efficient Capital Markets: II*, 46 The Journal of Finance 1575 (1991).....38

TABLE OF AUTHORITIES – Continued

Page

Roger Haydock and John Sonsteng, *Trial* (1991) 24

Orville Richardson, *Jury or Bench Trial? Considerations*, 19 Trial 58 (1983) 24

Margo Schlanger, *What We Know And What We Should Know About American Trial Trends*, 2006 J. Disp. Resol. 35 (2006) 23

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Thane International, Inc., William F. Hay, Denise DuBarry-Hay, Kevin McKeon and Mark Taylor respectfully petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Ninth Circuit in this case.

OPINIONS BELOW

The Ninth Circuit's original opinion (Pet. App. 31a) is reported at 508 F.3d 910 (9th Cir. 2007). A timely petition for panel rehearing and rehearing *en banc* was denied and an amended opinion substituted by order dated March 18, 2008. The amended opinion (Pet. App. 1a) is reported at 519 F.3d 879 (9th Cir. 2008). The district court's opinion (Pet. App. 62a) is reported at 372 F. Supp. 2d 1198 (C.D. Cal. 2005).

STATEMENT OF JURISDICTION

The Ninth Circuit entered its judgment on November 26, 2007. A timely petition for panel rehearing and rehearing *en banc* was denied March 18, 2008. Pet. App. 1a. This Court has jurisdiction under 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

Section 12 of the Securities Act of 1933, 15 U.S.C. § 77*l*, and Section 15 of the Securities Act of 1933, 15 U.S.C. § 77o, are set forth at Pet. App. 189a-191a.

PRELIMINARY STATEMENT

The Ninth Circuit's decision below joins one circuit split and creates another. The split the Ninth Circuit joined relates to the proper application of Federal Rule of Civil Procedure 52(a) ("Rule 52(a)"). The Ninth Circuit held in this case that it could apply a less deferential standard of review to the factual findings of a trial court that were based primarily on documentary evidence. This holding conflicts with decisions in the Fourth and Seventh Circuits, but is aligned with decisions in the First and Eleventh Circuits. The Fifth Circuit has issued decisions on both sides of this split.

The split the Ninth Circuit created relates to a fact-finder's ability to consider price in assessing materiality in a less than fully efficient securities market. The Ninth Circuit held in this case that the district court, sitting as the finder of fact in a bench trial, could not consider evidence of price in determining materiality in a securities market that was not fully efficient. The Ninth Circuit's holding created a conflict with a decision of the Second Circuit, which has held that price movements in an inefficient

market are highly relevant, although not dispositive, in assessing claims of materiality.

STATEMENT OF THE CASE

Following a bench trial of a class action under Section 12(a)(2) of the Securities Act of 1933, the Ninth Circuit reversed the factual findings of the district court and found material misstatements in a prospectus where the district court had found neither a misstatement, nor materiality assuming a misstatement could be construed.

In so doing, the Ninth Circuit (i) misapplied the correct standard of review for factual findings in a bench trial as set forth in Rule 52(a) in a manner that conflicts with the Fourth and Seventh Circuits and with this Court's opinion in *Anderson v. City of Bessemer*, 470 U.S. 564 (1985); and (ii) erroneously held that, as a matter of law, price movements were irrelevant to a determination of materiality in conflict with the Second Circuit and with this Court's opinions in *TSC Indus. v. Northway, Inc.*, 426 U.S. 438 (1976), *Basic, Inc. v. Levinson*, 485 U.S. 224 (1988), and *Affiliated Ute Citizens of Utah v. United States*, 406 U.S. 128 (1972).

Petitioners are defendants Thane International, Inc. ("Thane"), a direct marketing company, and certain of its current and former officers and directors. Plaintiffs are former shareholders of Reliant Interactive Media Corp. ("Reliant"), a company

incorporated in Nevada that merged with Thane. Prior to the merger, Reliant's stock traded on NASDAQ's Over-the-Counter Bulletin Board ("OTC-BB").

Plaintiffs allege that the merger prospectus created an implied promise that immediately upon completion of the merger, Thane would trade upon the NASDAQ National Market System ("NMS"). The district court held as a matter of fact that the prospectus made no such promise. After the merger, Thane was listed and traded upon the OTC-BB rather than the NMS.

After a bench trial consisting principally of competing economic expert testimony, the district court made factual findings that (i) the market recognized that Thane was trading on the OTC-BB rather than the NMS and (ii) this information was impounded into Thane's stock price within the first 19 days after the merger, during which time Thane traded at or above the "consideration paid," *see* 15 U.S.C. § 77*l*(a)(2), Pet. App. 189a, by plaintiffs. The district court held that the stock price's non-reaction to Thane's supposed "failure" to list on the NMS supported the conclusion that any implied promise to list (assuming one could be construed) was immaterial.

The Ninth Circuit reversed, holding that the prospectus in fact did make misleading statements regarding listing on the NMS and that these statements were material.

With respect to the finding of a misstatement, the Ninth Circuit held that because the district court's findings were based primarily on documentary evidence, the court of appeals was entitled to apply a less deferential form of "clear error" review.

Regarding materiality, the Ninth Circuit held that because Thane did not trade in an efficient market, prices were legally irrelevant to determining materiality. After excluding evidence of price, the Ninth Circuit proceeded to reweigh the expert testimony, and largely adopted the opinion of plaintiffs' expert in concluding that the misrepresentation it found was material. In reaching this conclusion, the Ninth Circuit initially held that materiality was subject to *de novo* review.

After a timely petition for rehearing, the Ninth Circuit amended its opinion to acknowledge that the correct standard of review for the materiality issue was "clear error." However, the Ninth Circuit did not amend the substance of its opinion in any material respect. *See infra* at 13-14.

A. Factual Background

1. The Thane-Reliant Merger

Thane is a direct to consumer marketing company. Reliant was also a direct marketing company that merged with a wholly-owned subsidiary of Thane.

Prior to the merger, Reliant's stock traded on the OTC-BB. The parties stipulated that prior to the merger, Reliant's securities traded in an efficient market.[1] Thane's stock was not publicly traded prior to the merger.

On November 21, 2001, Thane and Reliant executed a definitive merger agreement which was amended on or about December 6, 2001. On January 3, 2002, Thane filed with the SEC a combined proxy statement and prospectus, as part of a Registration Statement, on Form S-4. The Registration Statement was amended several times including on April 26, 2002, whereupon it was declared effective.

Prior to the merger, Reliant insiders comprising 62.69% of its total voting power contractually agreed to vote in favor of the merger. Because only a simple majority vote was required under Nevada law, the vote of class members was a formality and could not have prevented the merger from closing.

On May 24, 2002, the merger was completed and Thane's shares commenced trading on the OTC-BB. Based upon Reliant's prior public trading prices and the exchange ratio, plaintiffs calculated the merger price at $6.99 per share. (Defendants calculated the merger price as somewhat less, but that difference is immaterial here.)

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[1] Many of the facts in this case were stipulated to by the parties in the district court's pretrial order. Pet. App. 98a-108a.

2. Alleged Misrepresentations

Although plaintiffs asserted that the prospectus created an implied representation that Thane would immediately list its shares on the NMS, the district court agreed with defendants that it did not.

According to plaintiffs, the following illustrative statement in the prospectus formed the basis of a representation that there would be an immediate listing on the NMS:

> The shares of Thane common stock to be received by the stockholders of Reliant in connection with the merger have been approved for quotation and trading on the NASDAQ National Market upon completion of the merger, subject to Thane's compliance with the minimum bid price requirements of $5.00 per share.[2]

The district court concluded that this and similar statements did not imply a promise that Thane would list *immediately* after the merger. Pet. App. 79a.

As part of the merger process, Thane utilized the services of investment bankers who advised Thane that coordinating its anticipated NMS listing with a planned secondary offering would maximize shareholder value. The district court found that the secondary offering was anticipated to have been completed

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[2] There were several substantially similar statements in the prospectus and in an attached exhibit which are discussed in the district court opinion. *See* Pet. App. 66a-69a.

five to nine weeks later (i.e., between late June and July), depending on the SEC's review. Thane followed its investment bankers' advice. However, within a few weeks of the merger, Thane's price fell below NASDAQ's minimum bid requirement of $5.00 per share for listing on the NMS.

3. Post-Merger Events

On May 24, 2002, the Thane-Reliant merger was completed and Thane's shares commenced trading on the OTC-BB at $7.00. Between May 24, 2002 and June 11, 2002 – a period of 19 days – Thane's reported stock price was between $8.50 and $7.00 per share, i.e., above the merger price despite trading on the OTC-BB. During this time, only four percent of Thane's freely tradeable registered shares were sold.

Thane announced its earning results for the 2002 fiscal year on June 25, 2002, disclosing that Thane had earned $9.9 million in net income in 2002 ($0.30/share), as opposed to $16.0 million in 2001 ($0.50/share). On June 25, 2002, Thane's reported closing price was $5.25 per share. On June 28, 2002, Thane's stock price went below $5.00 per share for the first time, and thereafter remained below the $5.00 per share minimum bid price required for an NMS listing.

On August 14, 2002, Thane announced its earnings results for the first quarter of fiscal 2003, which were approximately 46% lower than the same quarter for the prior year. By August 16, 2002, the closing

price of Thane's shares had also declined approximately 46%.

In February 2004, nineteen months after the merger, Thane completed a going-private transaction.

B. Proceedings Before The District Court

Plaintiffs' complaint was filed in the California Superior Court for Riverside County and removed to the United States District Court for the Central District of California. The district court exercised federal question jurisdiction pursuant to 15 U.S.C. § 77v and 28 U.S.C. § 1331.

The complaint alleged a violation of Section 12(a)(2) of the Securities Act of 1933 against all defendants and control person liability against the individual defendants under Section 15 of the Securities Act of 1933. 15 U.S.C. §§ 77*l*(a)(2), 77o. District Judge James V. Selna granted plaintiffs' class certification motion on November 3, 2004.

The parties thereafter filed cross-motions for summary judgment and for the exclusion of expert testimony based on *Daubert v. Merrell Dow Pharms., Inc.*, 509 U.S. 579 (1993). On March 4, 2005, the district court granted in part defendants' summary judgment motion, holding, *inter alia*, that "there is no material issue of disputed fact that Thane's stock was at least somewhat efficient." Pet. App. 147a. Plaintiffs did not appeal this determination.

The district court also granted in part defendants' *Daubert* motion precluding plaintiffs' proffered expert from offering any calculation of damages, holding that her methodologies were inherently unreliable because she did not attempt to factor out price effects that were not attributable to the alleged misrepresentation. Plaintiffs did not appeal from the district court's order on this issue. The district court denied in its entirety plaintiffs' cross-motion to exclude the testimony of defendants' expert.

Defendants moved to strike plaintiffs' request for a jury trial on January 21, 2005. Plaintiffs initially opposed the motion but subsequently stipulated to a bench trial.

Pursuant to the district court's order, the parties submitted extensive declarations constituting the direct testimony of the percipient and expert witnesses, and the parties lodged transcript designations of the witnesses testifying by deposition.

A bench trial was held from April 12 through April 14, 2005. On June 2, 2005, the district court ruled in favor of defendants. Final judgment was entered on June 10, 2005.

The district court concluded that as a factual matter the prospectus made two representations relevant to this case: (i) Thane would use commercially reasonable efforts to cause its shares to be qualified and approved for quotation on the NMS or another national exchange; and (ii) Thane had in fact

so qualified subject to NASDAQ's $5.00 per share minimum price requirement.

Based on its reading of the prospectus and other factors, the district court found unpersuasive the testimony of plaintiffs' expert that a reasonable investor would have interpreted the prospectus as requiring that Thane "immediately" list on the NMS.

The district court also concluded that plaintiffs failed to establish the materiality of the alleged misrepresentation. The district court recognized that the market did not react negatively to the fact that Thane's stock traded on the OTC-BB upon completion of the merger, consistent both with immateriality and the absence of a misrepresentation.

After the first 19 days during which Thane's stock remained above the "consideration paid" by plaintiffs, *see* 15 U.S.C. § 77*l*(a)(2), Pet. App. 189a, Thane's stock experienced a slow steady descent, in line with the market as a whole and reflecting Thane's diminished business performance.

The district court's determination that Thane's stock price absorbed the fact of Thane's non-listing on the NMS within the first 19 days of the merger was well supported by the evidence. Not only did plaintiffs' expert concede that Thane's stock price had the ability to absorb information, but the district court noted that (i) Thane's "failure" to list on the NMS was "totally transparent"; (ii) Thane's stock reacted to general stock market and peer industry information, as well as to company specific events such as

earnings releases; (iii) plaintiffs themselves agreed that Reliant's stock (which had traded on the OTC-BB) traded in an efficient market; (iv) there was no rush to sell by shareholders even after it was obvious that Thane had not listed on the NMS; and (v) the non-listing was known promptly by investors who followed internet websites discussing Thane.

Moreover, the district court took note of the fact that even plaintiffs' expert's sources found that the benefits of switching from the OTC-BB to the NMS only occurred about 60% of the time and were on average *de minimis* (i.e., a less than 1% difference in bid-ask spreads) when they occurred. Plaintiffs' expert did not evaluate Thane according to the criteria used in the studies she referenced to determine whether Thane was likely to benefit from trading on the NMS. Pet. App. 87a (". . . Preston could not say what the result would be for Thane stock in terms of spread and volume, or even whether the changes would be positive."). The district court also weighed the testimony of defendants' expert who showed that Thane's stock had the ability to impound information into its price, and that the market's non-reaction to the lack of an NMS listing was consistent with economic theory, which posits that the market where a stock trades has a minor "second order" effect on price, if any. Based upon the evidence, the district court reasonably concluded that even if a misrepresentation had occurred, it was immaterial.

Finally, defendants offered an affirmative loss causation defense under Section 12(b) that plaintiffs

failed to rebut. The district court specifically declined to reach this issue because it felt it unnecessary in light of its other holdings.

C. The Ninth Circuit Opinions

The Ninth Circuit reversed the district court's holdings on the issues of both misstatement and materiality. In its original opinion, the Ninth Circuit held that the standard of review for materiality, as a mixed question of law and fact, was *de novo*. Pet. App. 40a-41a.

With respect to the existence of a misstatement, the Ninth Circuit held that although the standard for review was clear error, the "presumption of correctness" attaching to the district court's findings had "lesser force," because they were based primarily on the documentary record. Pet. App. 18a-19a (quoting *Bose Corp. v. Consumers Union of United States, Inc.*, 466 U.S. 485, 500 (1984)).

The Ninth Circuit agreed with the district court that the disputed statements in the prospectus were "literally true," Pet. App. 14a, but also stated that "literal truth is not the standard for determining whether statements in a prospectus are misleading." *Id.* at 15a. The Ninth Circuit held that the prospectus implied a promise to list on the NMS as soon as the $5.00 price condition was met "which was immediately upon merger." *Id.*

With respect to materiality, the Ninth Circuit described the district court as holding that "because Thane International stock did not depreciate *immediately* following its listing on the OTCBB, even though the market had the ability to incorporate that information into Thane International's share price, the fact of nonlisting on the NASDAQ was not material." *Id.* at 11a (emphasis added). In fact, the district court made no such holding. Instead, the district court held that Thane's stock price impounded the fact of non-listing on the NMS during the first *19 days* after the merger when the stock remained above the merger price. Pet. App. 92a-93a.

The Ninth Circuit also held "[t]he district court erred when it considered the movement in share price of a stock that did not trade on an efficient market." Pet. App. 20a. The Ninth Circuit cited no legal or economic authority for this proposition. The Ninth Circuit then reweighed the expert testimony considered by the district court and based largely on the testimony of plaintiffs' expert, concluded that "[a] reasonable Reliant shareholder would have wanted to know where the new Thane International shares would be trading and would have viewed the facts of Thane International's nonlisting 'as having significantly altered the "total mix" of information made available.'" Pet. App. 28a.

In its amended opinion, the Ninth Circuit made only three material changes to its prior opinion: (i) it changed its articulation of the standard of review for materiality from *de novo* to clear error, Pet. App. 11a;

(ii) it restated its central holding to state it was error for the district court to consider price movement in determining materiality "under the circumstances of this case," *id.* at 20a, but without explaining what those circumstances were; and (iii) it expanded the final paragraph of the materiality section to summarize its conclusions, *id.* at 28a-29a.

REASONS FOR GRANTING THE PETITION

I. The Ninth Circuit's Application Of Rule 52(a) Conflicts With That Of Other Circuits And With Prior Holdings Of This Court.

A. The First, Fourth, Fifth, Seventh, Ninth And Eleventh Circuits Are Split Over The Proper Application Of Rule 52(a).

In reviewing the district court's factual findings, the Ninth Circuit stated:

> The clear error standard is a high bar, but "the presumption of correctness that attaches to factual findings is stronger in some cases than in others. The same 'clearly erroneous' standard applies to findings based on documentary evidence as to those based entirely on oral testimony, but the presumption has lesser force in the former situation than in the latter."

Pet. App. 18a-19a (quoting *Bose Corp. v. Consumers Union of United States, Inc.*, 466 U.S. 485, 500 (1984)).

While the Ninth Circuit treated the district court's misrepresentation findings as "based almost entirely on the documentary record," Pet. App. 19a, the district court in fact considered a variety of evidence, including live testimony from percipient and expert witnesses explaining how they (and the market) interpreted the language of the prospectus. *See, e.g.*, Pet. App. 71a-79a. Notwithstanding this mischaracterization of the record, the Ninth Circuit improperly applied a less deferential standard of review to the district court's factual findings, which should have been given full deference even if they had been based entirely on a documentary record.

The Ninth Circuit's reliance on dicta from *Bose*,[3] a case decided prior to the 1985 amendment of Rule 52(a), puts it in direct conflict with the Seventh Circuit, which rejects a less deferential form of clear error review for factual findings in a bench trial based on documentary evidence:

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[3] *Bose* did not hold that a court may accord less deference to factual findings based on documentary evidence pursuant to Rule 52(a). Rather, *Bose* held that "the clearly-erroneous standard of Rule 52(a) does not prescribe the standard of review to be applied in reviewing a determination of actual malice in a case governed by *New York Times Co. v. Sullivan*." 466 U.S. at 514.

> While we have stated before that our "discretion within the 'clearly erroneous' standard is slightly broader" in a case where the district court relies in part on documentary evidence, *Clark v. Universal Builders, Inc.*, 706 F.2d 204, 206 (7th Cir. 1983), this view has recently been discredited by the Supreme Court, *Anderson v. City of Bessemer City*, 470 U.S. 564, 105 S. Ct. 1504, 1512, 84 L. Ed. 2d 518 (1985) (theory that appellate court can conduct more stringent review of factual findings based on documentary evidence cannot be traced to the text of Rule 52).

Planned Parenthood Ass'n/Chicago Area v. Chicago Transit Auth., 767 F.2d 1225, 1229 (7th Cir. 1985).[4]

The Fifth Circuit harbors an intracircuit split with conflicting decisions that do not address each other. *Compare McFarland v. T.E. Mercer Trucking Co.*, 781 F.2d 1146, 1148 (5th Cir. 1986) (1985 amendment to Rule 52(a) overruled both "the decisions of those circuits which failed entirely to apply the clearly erroneous standard to findings based on purely documentary evidence and the decisions of those circuits which did apply the clearly erroneous standard, but less deferentially, to such findings") *with Hall v. National Gypsum Co.*, 105 F.3d 225, 228

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[4] *See also Jennings v. Tinley Park Cmty. Consol. Sch. Dist. No. 146*, 864 F.2d 1368, 1373 (7th Cir. 1988) ("Our restriction against setting aside factual determinations is not eased when the trial court has decided the case without the benefit of observing trial witnesses testify.").

(5th Cir. 1997) ("When . . . the evidence relied upon by the district court in making its findings consist solely of documents in the record, the burden of establishing clear error is not so great as where the court engaged in the judging of witness credibility or in some other way was in a superior vantage point for finding facts.").[5]

More broadly, circuit courts have adopted starkly different positions concerning the appropriate standard of review for factual findings based on documentary evidence in a variety of procedural contexts, including motions to suppress and motions concerning jurisdiction. *Compare United States v. Stevenson*, 396 F.3d 538, 543 (4th Cir. 2005) (motion to suppress: "It is well-established that even when findings of fact are not based on observations of credibility, but rather on undisputed evidence or on entirely documentary evidence, appellate courts must nonetheless defer to the trial court's fact-finding function.") *with Padilla-Mangual v. Pavia Hosp.*, 516 F.3d 29, 33-34 (1st Cir. 2008) (subject matter jurisdiction based on diversity: "While the district court may rely on documentary evidence to establish whether jurisdiction attaches, and while the same clearly erroneous standard applies to findings based thereon, the

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[5] *See also Missouri Pac. R.R. Co. v. Railroad Comm'n of Texas*, 948 F.2d 179, 182 n.1 (5th Cir. 1991) (noting previous circuit authority applying lower deference to factual findings based on documentary evidence was "no longer valid given [the] 1985 amendment") (citing *McFarland*, 781 F.2d at 1148).

presumption that the court reached a correct result is somewhat lessened relative to findings based on oral testimony.") *and with Alexander Proudfoot Co. World Headquarters v. Thayer*, 877 F.2d 912, 916 (11th Cir. 1989) ("The appellate court, in reviewing the documentary evidence presented, is in as good a position as the district court to determine the existence of personal jurisdiction.").[6]

This confusion among the circuits can be traced, at least in part, to conflicting guidance from this Court. In *Anderson*, decided prior to the 1985 amendment, this Court stated:

> That [Rule 52(a)] goes on to emphasize the special deference to be paid credibility determinations does not alter its clear command: *Rule 52(a) "does not make exceptions* or purport to exclude certain categories of factual findings from the obligation of a court of appeals to accept a district court's findings unless clearly erroneous."

470 U.S. at 574 (emphasis added) (quoting *Pullman-Standard v. Swint*, 456 U.S. 273, 287 (1982)).

The 1985 amendment explicitly mandates clear error review for the factual findings of trial courts,

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[6] *See generally* Bryan L. Adamson, *Federal Rule of Civil Procedure 52(a) as an Ideological Weapon?*, 34 Fla. St. U. L. Rev. 1025, 1049 (2007) ("Appellate court standard of review varies wildly in cases in which the trial record is solely or predominantly made up of documentary evidence.").

whether based on oral or documentary evidence. Fed. R. Civ. P. 52(a) (1985) ("Findings of fact, *whether based on oral or documentary evidence*, shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge the credibility of the witnesses.") (emphasis on new text from 1985 amendment) (amended 2007).[7] As described above, several courts have held that *Anderson* and the 1985 amendment to Rule 52(a) overruled prior authority subjecting factual findings based on documentary evidence to a less deferential form of clear error review. *See, e.g.*, *Planned Parenthood*, 767 F.2d at 1229; *McFarland*, 781 F.2d at 1147; *Missouri Pac. R.R.*, 948 F.2d at 182 n.1.

In *Easley v. Cromartie*, 532 U.S. 234, 243 (2001), however, a bare majority of this Court noted that "the trial here at issue was not lengthy and the key evidence consisted primarily of documents and expert testimony" and held that "[a]ccordingly, we find that an extensive review of the District Court's findings, for clear error, is warranted." *Easley* did not make clear what it meant by an "extensive review" for clear error, and the dissent strongly criticized the conclusions as inconsistent with Rule 52(a) and prior precedent.

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[7] The 2007 amendment changed the phrase "documentary evidence" to "other evidence" which the 2007 Advisory Committee Notes state was "purely stylistic."

Easley, however, involved the review of a "constitutionally critical" determination of racial motivation in connection with legislative redistricting. 532 U.S. at 240. No decision of this Court subsequent to the 1985 amendment has suggested that courts of appeal could apply "extensive review" to a trial court's factual findings in a case not involving a significant constitutional question. Furthermore, while *Easley* cited *Bose*, it did not repeat *Bose*'s statement that a "lesser" "presumption of correctness" attached to factual findings based on documentary evidence.

The 1985 amendment to Rule 52(a) was expressly designed to promote judicial economy and to ensure the legitimacy of the bench trial by enforcing a policy of deference to the factual findings of trial courts:

> The principal argument advanced in favor of a more searching appellate review of findings by the district court based solely on documentary evidence is that the rationale of Rule 52(a) does not apply when the findings do not rest on the trial court's assessment of credibility of the witnesses but on an evaluation of documentary proof and the drawing of inferences from it, thus eliminating the need for any special deference to the trial court's findings. *These considerations are outweighed* by the public interest in the stability *and* judicial economy that would be promoted by recognizing that the trial court, not the appellate tribunal, should be the finder of facts. *To permit courts of appeals to share more actively in the fact-finding function*

> *would tend to undermine the legitimacy of the district courts in the eyes of litigants, multiply appeals by encouraging appellate retrial of some factual issues, and needlessly reallocate judicial authority.*

Advisory Committee's Notes on 1985 Amendment to Fed. R. Civ. P. 52, 28 U.S.C. App. at 662-63 (emphasis added).[8]

> The primary goals of the 1985 amendment were:
>
> (1) to avoid continued confusion and conflicts among the circuits as to the standard of appellate review of findings of fact by the court, (2) *to eliminate the disparity between the standard of review as literally stated in Rule 52(a) and the practice of some courts of appeals*, and (3) to promote nationwide uniformity.

Id. (emphasis added). The current split among the circuits demonstrates a failure to satisfy these objectives.

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[8] *See also* Adamson, *supra* note 5, at 1084-85 ("If the documentary evidence/clear error standard is to mean anything as stated in Rule 52(a), appellate courts must adhere to it without qualification – or remove it. . . . The interests of legitimacy, efficiency, and comity outweigh any rationale for departure from Rule 52(a)'s plain meaning.").

B. Consistent Application Of Rule 52(a) Promotes The Legitimacy Of Bench Trials And Judicial Economy.

While the number of civil actions in federal court disposed of by judgment at trial has been in decline for decades, both in absolute numbers and as a percentage of actions filed, the decline in bench trials is even more remarkable:

> [O]ver the past twenty-five years, jury trial rates have fallen much less than have bench trial rates. Jury trials have gone from about 2.5 percent of dispositions in 1979 to under 1 percent of dispositions in 2004. . . . But bench trials have diminished much more; from about 4.5 percent of dispositions to about .5 percent (a decrease of close to nine-tenths). . . . In other words, in federal courts, the jury trial may be shrinking, but it is the bench trial that is vanishing.

Margo Schlanger, *What We Know And What We Should Know About American Trial Trends*, 2006 J. Disp. Resol. 35, 36-37 (2006).

Several factors are, no doubt, responsible for the decline in trial activity in general, and in bench trials in particular. Many of these factors may be beyond this Court's ability to influence. This Court can, however, clearly address the aversion to bench trials that arises from the prevailing view among practitioners that, notwithstanding Rule 52(a), appellate courts are less deferential to judgments arising from bench trials than from jury trials. *See, e.g.*, George A.

Somerville, *Standards of Appellate Review*, *in* Appellate Practice Manual 25 (Priscilla Anne Schwab ed. 1992) ("Do not waste much time analyzing jury verdicts" because "appellate challenges to jury findings rarely succeed"); Roger Haydock and John Sonsteng, *Trial* 81 (1991) ("Appellate courts are much less likely to overturn the factual findings of a jury than those of a trial judge because the standards of review are higher in a jury case."); Orville Richardson, *Jury or Bench Trial? Considerations*, 19 Trial 58, 66 (1983) ("the limited ability of appellate courts to correct error after a general verdict in jury-tried cases . . . tend[s] to prevent satisfactory review of some jury verdicts. . . . A significantly different approach is made in the review of non-jury cases where facile remedies for error are at hand.").[9]

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[9] Recent empirical research challenges much of the accepted wisdom in this field. *See, e.g.*, Kevin Clermont & Theodore Eisenberg, *Appeal from Jury or Judge Trial: Defendants' Advantage*, 3 Am. Law & Econ. Rev. 125, 126 (2001); Theodore Eisenberg, *Appeal Rates and Outcomes in Tried and Nontried Cases: Further Exploration of Anti-Plaintiff Appellate Outcomes*, 1 J. Empirical Legal Stud. 659, 666 (2004). These empirical findings are, however, susceptible of criticism. For example, the research appears not to distinguish situations in which reversals occur because of an error in jury instructions, a cause that cannot arise in bench trials. Moreover, there is no indication that these empirical findings, even if correct, have changed practitioner conduct or altered the controlling perception that bench trials should be avoided because they are more readily reversed.

C. The Ninth Circuit's Review Of Materiality In This Case Conflicts With This Court's Decision In *Anderson*.

Several courts of appeals, including prior panels of the Ninth Circuit, have held that determinations of materiality in securities cases are subject to clear error review. *See, e.g., Arrington v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 651 F.2d 615, 619 (9th Cir. 1981) ("Questions of materiality . . . are mixed questions of law and fact, but ones involving assessments peculiarly within the province of the trier of fact. They are therefore reviewed under the clearly erroneous standard.") (citing *TSC Indus. v. Northway, Inc.*, 426 U.S. 438 (1976)).[10]

In its original opinion, the Ninth Circuit held that materiality, as a mixed question of fact and law, was subject to *de novo* review. Pet. App. 40a-41a. After denying a timely petition for rehearing that, among other things, pointed out the inappropriate standard the court had applied, the Ninth Circuit amended its opinion to restate the standard of review to clear error. This amendment was entirely cosmetic: there was no substantive change to the opinion,

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[10] *See also Toombs v. Leone*, 777 F.2d 465, 469 (9th Cir. 1985); *Lucas v. Florida Power & Light Co.*, 765 F.2d 1039, 1040 (11th Cir. 1985); *SEC v. Mize*, 615 F.2d 1046, 1053 (5th Cir. 1980); *Nash v. Farmers New World Life Ins.*, 570 F.2d 558, 561 & n.7 (6th Cir. 1978); *Rochez Bros., Inc. v. Rhoades*, 491 F.2d 402, 408 (3d Cir. 1974).

which still constituted a *de novo* reweighing of the evidence. As this Court has held, merely providing the correct label is insufficient. *Anderson*, 470 U.S. at 576 ("In detecting clear error in the District Court's finding . . . the Fourth Circuit improperly conducted what amounted to a *de novo* weighing of the evidence in the record."); *see also Easley*, 532 U.S. at 259 (Thomas, J., dissenting) ("incantations of the correct standard are empty gestures").

The artificiality of the Ninth Circuit's clear error label is underscored by its central holding that, "[t]he district court erred when it considered the movement in share price of a stock that did not trade on an efficient market to determine materiality *under the circumstances of this case*. Therefore, its conclusion that Thane International's misrepresentations were immaterial is *clear* error." Pet. App. 20a (emphasis on newly added text).

Because the Ninth Circuit cited no legal or economic support for its holding, "the circumstances of this case" can only refer to a factual reweighing of the evidence, which is precisely what the court did. *Cf. Easley*, 532 U.S. at 262 (Thomas, J., dissenting) ("Finally, perhaps the best evidence that the Court has emptied clear error review of meaningful content in the redistricting context (and the strongest testament to the fact that the District Court was dealing with a complex fact pattern) is the Court's foray into the minutiae of the record."). The Ninth Circuit basically adopted the opinion of plaintiffs' expert regarding materiality. *Compare* Pet. App. 25a-28a

(amended opinion) *with* Pet. App. 205a-208a (Plaintiffs' expert's trial declaration). It was within the district court's fact-finding authority to favor one expert over another, particularly after having heard live cross-examination testimony and itself questioning the experts in court. *See D & S Redi-Mix v. Sierra Redi-Mix and Contracting Co.*, 692 F.2d 1245, 1248 (9th Cir. 1982). The Ninth Circuit simply reversed that choice without the benefit of observing that testimony.

The Ninth Circuit also treated materiality as an abstraction, based on what it believed would have been important to a hypothetical reasonable investor. *See, e.g.*, Pet. App. 28a ("A reasonable Reliant shareholder would have wanted to know that in fact Thane International would not be listed on the NASDAQ . . . ."). The Ninth Circuit cited *TSC* as supporting its determination of materiality, but this Court in *TSC* said that "The determination [of materiality] requires delicate assessments of the inferences a 'reasonable shareholder' would draw from a given set of facts and the significance of those inferences to him, *and these assessments are peculiarly ones for the trier of fact*." 426 U.S. at 450 (emphasis added). This Court then went on to cite "the jury's unique competence in applying the 'reasonable man' standard . . . ." *Id.* at 450 n.12. In this case the trial judge, sitting in a bench trial, performed that "reasonable man" function.

Whereas most cases discussing materiality, (including *TSC*) involve preliminary motions short of trial where the relevant question is hypothetically

stated as whether a trier of fact "could" find an alleged misstatement or omission to be material, this case differs. It presents the question in a non-hypothetical context: there was an actual trial, testimony was heard, and a trier of fact reached a determination. The Ninth Circuit simply disagreed with the fact-finder's assessment, and, contrary to *Anderson*, reweighed the facts to reach a different result.

II. The Ninth Circuit's Unsupported Holding As To Materiality Creates A Circuit Split, Conflicts With Prior Holdings Of This Court, And Is Inconsistent With Modern Finance Theory.

A. The Ninth And Second Circuits Are Split Over The Ability To Refer To Price Information In Inefficient Markets To Determine Materiality.

In the Second Circuit, courts may consider price information when assessing materiality in an inefficient market. *Akerman v. Oryx Commc'ns, Inc.*, 609 F. Supp. 363 (S.D.N.Y. 1984), *aff'd*, 810 F.2d 336 (2d Cir. 1987). In the Ninth Circuit, however, "[t]he district court erred when it considered the movement in share price of a stock that did not trade on an efficient market to determine materiality . . . ." Pet. App. 20a.

The parallels between the facts of *Akerman* and *Thane* are striking. Plaintiffs in *Akerman* alleged that a misrepresentation in the registration

statement of a newly-listed issuer that traded over-the-counter was material. The company raised only $3 million of capital in its initial public offering. 609 F. Supp. at 365. Its stock was thinly traded at relatively low prices ranging from $3.25 to $4.75 per share. *Id.* In a stock price trading pattern highly reminiscent of *Thane*, the district court observed that the registrant's stock price "remained stable in the two-week period" following disclosure of the alleged misrepresentation. *Id.* at 370.

The district court in *Akerman* considered this price evidence when ruling that "[a]lthough plaintiffs may be correct, *as a theoretical matter*, that the kind of statement Oryx made in its prospectus can be material . . . they have *failed to show that Oryx's statements were in fact material*, in other words, that they caused whatever losses plaintiffs may have suffered." *Id.* at 368 (emphasis added). The court also noted that "the lack of a significant drop in the price of Oryx's stock after disclosure by itself [does not] establish immateriality as a matter of law" because of factual issues regarding market information and price impoundment for thinly traded stocks. *Id.* Put another way, in *Akerman*, price was a factor, although not a determinative factor, in assessing materiality.

The district court's determination in *Akerman* that the misstatement was material only "as a theoretical matter" also closely parallels the district court's determination in *Thane* that "in a vacuum – that is, without regard to price effects – the Court would find that listing on the NMS is marginally

material." Pet. App. 86a. The district court in *Thane* went on to clarify that the absence of a price reaction "negate[d] a finding of materiality, and confirm[ed] the view that the Court's finding of marginal materiality in the abstract was overly generous." *Id.* at 92a-93a.

While the Ninth Circuit rejected this reasonable factual finding in *Thane*, the Second Circuit in *Akerman* embraced the district court's ruling. Indeed, in concluding that the "misstatement was not likely to cause a stock price decline," 810 F.2d at 341, the Second Circuit observed that "the public not only did not react adversely to disclosure of the misstatement, Oryx's price actually *rose* somewhat after public disclosure of the error." *Id.* (emphasis in original). The Second Circuit thus relied expressly on the very price information that the Ninth Circuit in *Thane* held cannot be considered.[11]

Thane is also inconsistent with this Court's prior decisions in *TSC*, *Basic*, and *Affiliated Ute*. In *TSC*, this Court explained that the materiality of

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[11] As the Second Circuit said regarding one of the expert studies offered by the defendants:

> This study [which] focused strictly on Oryx's price behavior . . . appears to be the most germane statistical evidence offered at trial. . . . The test's results support[] the hypothesis that Oryx's price change over the period from its [IPO] date to the time of suit was consistent with reasonably assumed chance laws . . . .

810 F.2d at 341 n.2 (internal quotation marks omitted).

information must be considered in light of the "total mix" of information available to the market. 426 U.S. at 449. No decision of this or any other court holds that any form of information – whether related to price or any other factor – is, as a matter of law, ever precluded from consideration as part of *TSC*'s "total mix" of available information.

In *Basic*, this Court held that materiality is a "fact-specific inquiry," 485 U.S. at 240, and rejected a per se rule that "preliminary merger discussions do not become material until 'agreement-in-principle' as to the price and structure of the transaction has been reached between the would-be merger partners." *Id.* at 233. *Basic* also held that "[a]ny approach that designates a single fact or occurrence as always determinative of an inherently fact-specific finding such as materiality, must necessarily be overinclusive or underinclusive." *Id.* at 236. It follows that a per se rule excluding a fact-finder from considering evidence of price in markets that are not fully efficient violates this precept from *Basic*.

Further, in *Affiliated Ute*, this Court expressly considered price information to be, in and of itself, a "material fact" that investors would want to know, even though the market was clearly inefficient: "The sellers had the right to know that the defendants were in a position to gain financially from their sales and that their shares were selling for a higher price in that market." 406 U.S. at 153.

In addition to creating a conflict with the Second Circuit and failing to follow this Court's previous decisions, the Ninth Circuit's decision in *Thane* is internally inconsistent. While asserting that it is error to consider stock price in an inefficient market when assessing materiality, the Ninth Circuit also asserts that "pennies count in the world of investing," Pet. App. 26a-27a, "[e]specially for stocks, like Thane International, that trade in a relatively low price range." *Id.* at 27a n.9. But if "pennies count," and if price is the measure of those pennies, it is then irrational to ignore those pennies for purposes of assessing materiality.

B. The Ninth Circuit's Opinion Conflicts With Modern Finance Theory And Common Sense.

In holding that the district court erred in considering price movement to determine materiality for "a stock that did not trade on an efficient market," the Ninth Circuit acted without any citation to or support in the record, in judicial precedent, or in the academic literature, and contrary to the opinion of *both* experts who testified below and who agreed that efficiency is a matter of degree.[12]

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[12] *See* Pet. App. 90a, 147a. *See also Eckstein v. Balcor Film Investors*, 8 F.3d 1121, 1130 (7th Cir. 1993) ("'Efficiency' is not an all-or-nothing phenomenon. . . . Prices of even poorly followed stocks change in response to news, including statements by the

(Continued on following page)

The Ninth Circuit ignored the finding of the district court at summary judgment, which plaintiffs never appealed, that "there is no material issue of disputed fact that Thane's stock was at least somewhat efficient," Pet. App. 147a, and instead viewed the market for Thane's shares as entirely inefficient. Pet. App. 20a. The district court's treatment of Thane's stock as partially efficient is consistent with finance theory which recognizes that efficiency is measured on a continuum and defined with respect to particular information sets.[13] The Ninth Circuit, in contrast, provided no support for its conclusion either in the record or in the literature.

The district court recognized that Thane's stock price responded in a statistically significant manner to adverse earnings information within two to three days of that event, Pet. App. 89a-91a, a fact also recognized by the Ninth Circuit. *See* Pet. App. 8a. The district court also recognized that Thane's stock did not move in a "random walk"; instead it closely followed both the overall NASDAQ Market Index and an index of its competitors. *Id.* at 91a (citing trial exhibits 188-D, Pet. App. 298a, and 190-D, Pet. App. 302a).

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issuers . . . . Even an 'inefficient' market price is objective and contemporaneous with events . . . .").

[13] *See* William F. Sharpe, Gordon J. Alexander & Jeffery V. Bailey, *Investments*, 106 (5th ed. 1995) ("A market is efficient *with respect to a particular set of information* if it is impossible to make abnormal profits by using this set of information to formulate buying and selling decisions.") (emphasis added).

Not all information is alike, and some types of information are easier to impound into stock price than others.[14] The information allegedly misstated here was one of the most obvious and easily digested bits of information conceivable: the market on which the stock traded. The fact that Thane could react to relatively complex information such as earnings releases within a short time gave Thane's expert (and the district court which credited his testimony) confidence that as a matter of fact, and by a preponderance of the evidence, Thane's stock price absorbed the more obvious fact of non-listing on the NMS within the first 19 days after the merger, the period during which its stock price equaled or even exceeded the merger price.

C. The Ninth Circuit's Opinion Exacerbates A Pre-Existing Circuit Split Concerning The Relationship Between Price And Materiality Under The Efficient Market Theory.

The confusion concerning proper application of the efficient market theory to questions of materiality runs deeper than just this case. The circuits are also

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[14] *See Oscar Private Equity Invs. v. Allegiance Telecom, Inc.*, 487 F.3d 261, 269 (5th Cir. 2007) ("the market price of a security will not be uniformly efficient as to all types of information") (quoting Jonathan R. Macey & Geoffrey P. Miller, *Good Finance, Bad Economics: An Analysis of the Fraud-on-the-Market Theory*, 42 Stan. L. Rev. 1059, 1083 (1990)).

split concerning the relationship between price and materiality in efficient markets.

The Third Circuit has adopted a "bright-line" approach: the failure of a stock price promptly to react to a corrective disclosure demonstrates the immateriality of a misstatement or omission as a matter of law. *See In re Burlington Coat Factory Sec. Litig.*, 114 F.3d 1410, 1425 (3d Cir. 1997); *Oran v. Stafford*, 226 F.3d 275, 283 (3d Cir. 2000). The Ninth Circuit has rejected the bright-line approach, holding that the failure of an efficient market to swiftly react to a corrective disclosure is not dispositive of materiality. *No. 84 Employer-Teamster Joint Council Pension Trust Fund v. America West Holding Corp.*, 320 F.3d 920, 934-35 (9th Cir. 2003) (a *seven week* delay between a press release announcing America West's fine and settlement with the FAA, and a later price effect, did not preclude a finding of materiality).

The Fifth Circuit has adopted a rule similar to the Third Circuit rule, but it relates the requirement of an immediate price reaction to the element of reliance rather than materiality. *See Nathenson v. Zonagen, Inc.*, 267 F.3d 400, 415 (5th Cir. 2001) ("While we agree with *Burlington* . . . we conclude that it is more appropriate in such cases to relate this requirement to reliance rather than to materiality."). The First Circuit has not directly ruled on whether the absence of an immediate price reaction is dispositive of materiality, but its holdings concerning the definition of an efficient market are implicitly aligned with the Third Circuit's position. *See In re Polymedica*

Sec. Litig., 432 F.3d 1, 14 (1st Cir. 2005) ("[A]n efficient market is one in which the market price of the stock *fully reflects all* publicly available information. . . . [This implies] prices respond so quickly to new information that it is impossible for traders to make trading profits on the basis of that information") (emphasis added).[15]

These inconsistent positions can be traced to this Court's decision in *Basic*. There a plurality of four Justices, Blackmun, Brennan, Marshall, and Stevens, held that it was "not inappropriate to apply a presumption of reliance supported by the fraud-on-the-market theory." 485 U.S. at 250. Justices White and O'Connor disagreed with this section of *Basic*'s holding. They described the fraud-on-the-market theory as being intellectually and legally a "mere babe," and noting that "today, the Court embraces this theory with the sweeping confidence usually reserved for more mature legal doctrines." *Basic*, 485 U.S. at

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[15] The Second Circuit has not yet addressed this issue, although a district court recently observed that the "vitality of [*Oran*] is a matter of significant doubt in this Circuit." *In re Take-Two Interactive Sec. Litig.*, ___ F. Supp. 2d ___, 2008 WL 1757823, at *34 (S.D.N.Y. Apr. 16, 2008). The Sixth Circuit has taken a position that is ambiguous and seemingly internally inconsistent. *See City of Monroe Employees Ret. Sys. v. Bridgestone Corp.*, 399 F.3d 651, 676 (6th Cir. 2005) (holding that "in an open and efficient securities market 'information important to reasonable investors (in effect, the market) is immediately incorporated into stock prices' " but treating a price reaction over a six week period as constituting such a reaction) (quoting *Burlington*, 114 F.3d at 1425).

250-51 (White, J., dissenting). The dissenters warned that as a result, "[c]onfusion and contradiction in court rulings are inevitable . . . ." *Id.* at 252.

Basic's dissenters were prescient. The split in the circuits can be traced largely to the majority's statement in *Basic* that "we do not intend conclusively to adopt any particular theory of how quickly and completely publicly available information is reflected in market price." *Id.* at 249 n.28.

In *America West*, the Ninth Circuit relied upon *Basic* for the propositions that "[t]he market is subject to distortions that prevent the ideal of 'a free and open public market' from occurring" and that "these distortions may not be corrected immediately." 320 F.3d at 934. In fact, however, *Basic* never characterized securities markets as being subject to "distortions" that would somehow preclude disclosures of information from being rapidly impounded into the price of a stock trading in an efficient market (which supposedly was the case in *America West*).[16] Nevertheless, the Ninth Circuit cited *Basic*'s refusal to "conclusively . . . adopt [a] particular theory of how quickly

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[16] The only reference to a "distortion" in *Basic* is its statement that defendants may rebut the presumption of reliance by "show[ing] that the misrepresentation in fact did not lead to a distortion of price . . . ." *Id.* at 248. This refers to the potential distortion in a security's value caused by a misrepresentation, not a market distortion that precludes the market from absorbing the truth once it is revealed, and incorporating that new fact into price.

and completely information is reflected in market price," and transformed it into an extremely permissive rule for materiality in supposedly efficient markets: a rule for which the Ninth Circuit cites no support in the economic literature, and which is fundamentally at odds with the semi-strong form of the efficient market theory which most courts have adopted.[17]

The combination of the Ninth Circuit's holdings in *America West* and *Thane* exacerbate the pre-existing split between the Ninth Circuit and the Third and Fifth Circuits. *America West* establishes the split by rendering prompt price movements essentially irrelevant to the determination of materiality in efficient markets. *Thane* then widens the gulf by making price irrelevant as a matter of law if the market is inefficient. Thus, while the First, Third, and Fifth Circuits are tying their analyses of securities fraud actions ever more closely to stock price movement, the Ninth Circuit, alone among all the circuits, aggressively marginalizes stock prices' role in assessing the materiality of a misrepresentation or omission.

This case presents an excellent vehicle for review of the relationship between materiality and price under the efficient market theory. With respect to the

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[17] *See* Eugene F. Fama, *Efficient Capital Markets: II*, 46 The Journal of Finance 1575, 1601-02 (1991) (noting that efficient stocks generally respond to new information within one day).

pre-existing circuit split concerning the relationship between price movements and materiality in efficient markets, complicating factors may make it difficult for a proper case to ripen for review. While the Third Circuit's bright-line rule serves to rein in exposure for immaterial misstatements at the motion to dismiss stage, the Ninth Circuit's "fact-specific inquiry" test can expose litigants to the vagaries of a jury.[18] Review of an erroneous jury verdict, however, may be difficult, because juries do not create detailed factual findings explaining their verdicts. In contrast, this case offers a robust record with detailed factual findings providing the Court with an excellent opportunity to provide clear guidance concerning the relationship between materiality and price, and the proper application of the efficient market theory.

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[18] Recently a district court entered a jury verdict estimated at $190 million, despite evidence that the relevant information entered the market through newspaper articles a week before the stock price decline. *See In re Apollo Group, Inc. Sec. Litig.*, 509 F. Supp. 2d 837 (D. Ariz. 2007) (denying summary judgment in reliance on *America West*); 2008 WL 410625 at *1-3 (D. Ariz. Feb. 13, 2008) (entering stay contingent upon posting of $95 million bond).

CONCLUSION

For the reasons stated above, the petition for certiorari should be granted.

Respectfully submitted,

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June 16, 2008

TABLE OF APPENDICES

Page

Appendix A – Amended Opinion of the United States Court of Appeals for the Ninth Circuit on Petition for Rehearing, dated March 18, 2008 ..... 1a

Appendix B – Opinion of the United States Court of Appeals for the Ninth Circuit, filed November 26, 2007 ..... 31a

Appendix C – Judgment of the United States District Court for the Central District of California, filed June 10, 2005 ..... 59a

Appendix D – Memorandum of Decision of the United States District Court for the Central District of California, dated June 2, 2005 ..... 62a

Appendix E – Final Pretrial Conference Order of United States District Court for the Central District of California, filed March 28, 2005 ..... 95a

Appendix F – Order of the United States District Court for the Central District of California on Motions for Summary Judgment, dated March 3, 2005 ..... 139a

Appendix G – Order of the United States District Court for the Central District of California on Motions to Strike Experts' Reports 168a

TABLE OF APPENDICES – Continued

Page

Appendix H – Section 12 of the Securities Act of 1933, 15 U.S.C. § 77*l*, and Section 15 of the Securities Act of 1933, 15 U.S.C. § 77o.....189a

Appendix I – Trial Declaration of Plaintiffs' Expert Candace L. Preston.....192a

Appendix J – Trial Declaration of Defendants' Expert Bradford Cornell.....217a

Appendix K – Trial Exhibit 44, Expert's Report of Bradford Cornell, including Exhibit 13 to the Report.....262a

Appendix L – Trial Exhibit 188-D (Thane International vs. Value Weighted Peer Group and NASDAQ Composite Indices, May 24, 2002 – June 24, 2002).....297a

Appendix M – Trial Exhibit 189-D (Thane International vs. Value Weighted Peer Group and NASDAQ Composite Indices, June 28, 2002 – August 13, 2002).....299a

Appendix N – Trial Exhibit 190-D (Thane's Stock Price Decline After the August 14, 2002 Earnings Announcement was in Proportion to the Announced Decrease in Earnings Per Share).....301a

Appendix O – Trial Exhibit 191-D (According To The Authorities Cited by Plaintiffs' Expert, Average Quotation Spreads Only Changed by $0.057 When Companies Moved to the NMS from NASDAQ).....303a

TABLE OF APPENDICES – Continued

Page

Appendix P – Trial Exhibit 192-D (According to the Authorities Cited by Plaintiffs' Expert, Average Percentage Spreads Only Changed by 0.782% When Companies Moved to the NMS from NASDAQ) 305a

APPENDIX A

519 F.3d 879

United States Court of Appeals, Ninth Circuit.
Howard MILLER, on behalf of himself and all others similarly situated; Joseph J. Milkowski, Plaintiffs-Appellants,
v.
THANE INTERNATIONAL, INC.; William F. Hay; Denise Dubarry-Hay; Kevin J. McKeon; Mark Taylor, Defendants-Appellees.
No. 05-56043.

Argued and Submitted May 9, 2007.
Filed Nov. 26, 2007.
Amended March 18, 2008.

Joel C. Feffer and Daniella Quitt, Wechsler Harwood LLP, New York, NY, and Lionel Z. Glancy and Peter A. Binkow, Glancy Binkow & Goldberg LLP, Los Angeles, CA, for the plaintiffs-appellants.

Daniel J. Tyukody and Michael C. Tu, Orrick, Herrington & Sutcliffe LLP, Los Angeles, CA, for the defendants-appellees.

Appeal from the United States District Court for the Central District of California; James V. Selna, District Judge, Presiding. D.C. No. CV-03-01031-JVS.

Before: BARRY G. SILVERMAN, KIM McLANE WARDLAW, and JAY S. BYBEE, Circuit Judges.

ORDER AND AMENDED OPINION

ORDER

The opinion filed November 26, 2007 and published at 508 F.3d 910 is superseded by the amended opinion below.

The panel has voted to deny Appellees' Petition for Rehearing and Suggestion of Rehearing En Banc.

The full court has been advised of the Suggestion of Rehearing En Banc, and no active judge has requested a vote on whether to rehear the matter en banc. Fed. R.App. P. 35.

The Petition for Rehearing and Suggestion of Rehearing En Banc are **DENIED.** No further petitions for rehearing may be filed.

AMENDED OPINION

WARDLAW, Circuit Judge:

Class plaintiffs appeal the district court's judgment, following a bench trial, in favor of Thane International, Inc. and its officers and directors (collectively, "Thane International") on plaintiffs' action brought under Section 12(a)(2) of the Securities Act of 1933 (the "Act"), 15 U.S.C. § 77*l*(a)(2) and under Section 15 of the Act, 15 U.S.C. § 77*o*, alleging control person liability against individual defendants. We must decide whether Thane International misrepresented to investors that it would list its shares on the NASDAQ National Market System ("NASDAQ"),

and if so, whether those misrepresentations were material. The district court answered "no" to both questions. We have jurisdiction under 28 U.S.C. § 1291. We hold that the district court clearly erred when it found that Thane International did not misrepresent that it would list the merged company's shares on the NASDAQ. We also hold that these misrepresentations were material. We therefore reverse and remand for further proceedings.

I. Factual and Procedural Background

This appeal arises out of a merger transaction between Reliant Interactive Media Corporation ("Reliant"), a publicly traded corporation, and Thane International, a privately held corporation. Reliant and Thane International executed an agreement and plan of merger on November 21, 2001, which was amended on December 6, 2001. Under the terms of the agreement, Reliant shareholders would receive 0.3049459 shares of Thane International common stock for each share of Reliant common stock surrendered upon completion of the merger. A wholly owned subsidiary of Thane International would merge with and into Reliant. The separate corporate existence of the subsidiary would cease, and Reliant would continue as the surviving corporation. Reliant would then become a wholly owned subsidiary of Thane International. Premerger, Reliant stock traded on the Over-the-Counter Bulletin Board ("OTCBB"), while Thane International's stock was not publicly traded.

On January 3, 2002, Thane International filed a combined proxy statement and prospectus (the "Initial Prospectus"), as part of a Registration Statement on Form S-4, with the Securities and Exchange Commission ("SEC"). The stockholder letter accompanying the Initial Prospectus stated that, as a condition to the merger, Thane International shares would be listed for trade on the NASDAQ, or another national exchange:

> It is a condition to the merger that the shares of Thane common stock to be received by stockholders of Reliant in connection with the merger be quoted or listed on the NASDAQ national market or a national securities exchange.

The Registration Statement was amended on February 21, 2002, March 29, 2002, April 23, 2002, and finally, on April 26, 2002, at which point the SEC declared it effective (the "Final Prospectus"). In the meantime, by letter dated April 9, 2002, NASDAQ notified Thane International that its shares were approved for listing on the NASDAQ.

The Final Prospectus omitted the express listing condition found in the Initial Prospectus. Although there are several references to listing the merged company's stock on the NASDAQ sprinkled throughout the Final Prospectus, those references contained literal representations that the merged company's shares had been approved for trading on the NASDAQ, and not that the shares were actually

listed on the NASDAQ. For example, the cover page of the Final Prospectus states:

> The shares of Thane common stock to be received by stockholders of Reliant in connection with the merger have been approved for quotation and trading on the NASDAQ National Market upon completion of the merger, subject to Thane's compliance with the minimum bid price requirements of $5.00 per share.

Under the heading "Reliant's Reasons for the Merger," the Prospectus represents:

> The combined company is expected to meet the initial listing requirements of the NASDAQ National Market, which would provide the Reliant stockholders with greater liquidity than they have with Reliant common stock trading on the over-the-counter market.

Under the heading "Per Share Market Price Information," the Prospectus informed investors:

> The Thane common stock to be issued in connection with the merger has been approved for quotation and trading on the Nasdaq National Market upon the completion of the merger, subject to Thane's compliance with the minimum bid price requirements of $5.00 per share.

In the Final Prospectus's section on "QUESTIONS AND ANSWERS ABOUT THE MERGER," the hypothetical investor asks, "Will Reliant continue as a public company if the merger agreement is

approved?" The hypothetical investment advisor replies:

> No. Reliant will become a wholly-owned subsidiary of Thane upon the completion of the merger, and Reliant stockholders will become holders of Thane common stock. Thane has received approval for quotation and trading of its common stock on the Nasdaq National Market upon completion of the merger, subject to Thane's compliance with the minimum bid price requirements of $5.00 per share.

The Final Prospectus also included a copy of the Merger Agreement. Section 6.5(b) of the Merger Agreement discussed Thane International's covenant to secure the NASDAQ listing:

> Thane shall use commercially reasonable efforts to cause its outstanding Thane Common Stock immediately after the Merger to be approved for quotation on the Nasdaq National Market System or, in Thane's reasonable discretion another national securities exchange, subject to official notice of issuance, as promptly as practicable after the date hereof, and in any event prior to the Effective Time.

Thane International was required to "compl[y] in all material respects with all covenants" as a condition precedent to Reliant's obligation to consummate the merger. In the April 9, 2002 letter, NASDAQ notified Thane International that it had approved Thane International's listing application. However, in

April 2002, members of Thane International's Board of Directors met with their investment bankers, who advised the Board that shareholder value would be maximized if Thane International did not list its common stock on the NASDAQ immediately after the merger, but instead waited to list once a secondary offering of shares was completed. According to William Hay, Thane International's Chairman and Chief Executive Officer, the secondary offering was to be completed as early as mid-July, approximately six weeks after the merger was consummated. During those six weeks, the bankers recommended that Thane International trade its shares on the OTCBB.

On May 20, 2002, Reliant's shareholders approved the merger, which was consummated on May 24, 2002. Thane International stock commenced trading that day over the OTCBB.

Thane International shareholders experienced a wild ride. Between May 24 and June 11, 2002, the reported share price ranged between $8.50 and $7.00.[1] The stock closed at $6.00 on June 24, 2002. Thane International reported its Fiscal Year 2002 earnings on June 25, 2002, and the stock closed that day at $5.25. On June 28, 2002, Thane International's

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[1] Plaintiffs calculate the "merger price" – the value of Reliant stock each Reliant shareholder exchanged for each Thane International share they received as part of the merger – at $6.99 per share, while defendants calculate it at $6.89 per share. We agree with the district court that resolution of this dispute does not affect the outcome of this case.

closing price sunk below $5.00 per share, and never again closed above $5.00.

On August 14, 2002, Thane International announced its quarterly earnings in its 10-Q filing with the SEC. The results were disastrous, with earnings falling 46 percent over the same quarter the previous year. Apparently, there was a general slump in the industry about this time. This was compounded by the company's failure to find and market the "hit" product it had hoped to find. Thane International's flagship product, an exercise machine called the "AB-Doer," was not flying off the shelves as it once had. The 10-Q stated:

> In May and June of [2002], we met with our investment bankers to discuss an underwritten public offering of our common stock. Our investment bankers advised us that we could potentially obtain more favorable pricing for the public offering if we implemented our move to the NASDAQ National Market in conjunction with the underwritten [secondary] public offering. Over the course of June and July we have been preparing for the public offering, but we have recently concluded that present market conditions are no longer favorable for an underwritten public offering of common stock. As such, we are currently evaluating the listing of our common stock on a national market.

Thane International shares tumbled on the news, closing at $1.95 on August 16, 2002.

In February 2004, Thane International completed a "going-private" transaction in which all Thane International shareholders were bought out at $0.35 per share. The shares had never been listed on the NASDAQ.

Plaintiffs filed an action in the district court, alleging violations of Section 12(a)(2) of the Act, 15 U.S.C. § 77*l*(a)(2), for misrepresentation in connection with a securities offering and of Section 15 of the Act, 15 U.S.C. § 77*o*, for control person liability against individual defendants William Hay; Denise DuBarry-Hay, William Hay's wife and Thane International's Chief Creative Officer; Kevin McKeon, Thane International's Chief Financial Officer; and Mark Taylor, Thane International's Chief Operating Officer and President. Plaintiffs allege that the Final Prospectus contained material misstatements of fact because it implied that Thane International shares would be listed on the NASDAQ. The district court certified the plaintiff class and confirmed Joseph J. Milkowski as the named class representative.

The district court conducted a three-day bench trial. In a Memorandum of Decision, the district court held that the defendants had not violated Section 12(a)(2) of the Act for two reasons. *Miller v. Thane Int'l, Inc.*, 372 F.Supp.2d 1198 (C.D.Cal.2005). First, the district court found that the statements in the Final Prospectus regarding NASDAQ listing were not false or misleading. *Id.* at 1205-06. The court reasoned that the representations in the Final Prospectus were "literally true," in that they did not promise

that Thane International shares would actually be listed on the NASDAQ. *Id.* at 1205. Rather, they merely represented that the shares would be or already had been *approved* or *qualified* for NASDAQ listing. *Id.* at 1204. The district court contrasted this representation with that determined to be false in *Blasdel v. Mullenix,* 356 F.Supp. 924, 925 (W.D.Okla.1971), where the defendant had represented that the corporation's shares "would be listed" on the New York Stock Exchange. *Miller,* 372 F.Supp.2d at 1205.

The district court also gave weight to the "drafting history of the Prospectus," finding it "reinforce[d]" his conclusion that the representations are literally true. *Id.* The district court noted that the Initial Prospectus contained an explicit condition that the merger would be completed only if Thane International listed its shares on the NASDAQ, but that the condition had been omitted from subsequent versions of the prospectus – including the Final Prospectus. *Id.* The district court concluded that dropping this condition demonstrated that Thane International did not actually promise to list its shares on the NASDAQ because "if a condition to list is eliminated, a reasonable investor would infer that there was no promise to list." *Id.*

Second, in the alternative, the district court held that even if the Final Prospectus contained false statements, those statements were not material. *Id.* at 1208-09. After hearing from both sides' experts, the district court considered the movement in Thane

International's share price in the aftermath of the merger as a probative indicator of materiality, even though it acknowledged that Thane International's shares did not trade on an efficient market. *Id.* at 1206-11. It held that because Thane International stock did not depreciate immediately following its listing on the OTCBB, even though the market had the ability to incorporate that information into Thane International's share price, the fact of nonlisting on the NASDAQ was not material. *Id.* at 1210-11.

Plaintiff class timely appealed.

II. Jurisdiction and Standard of Review

We have jurisdiction over final judgments of the district court under 28 U.S.C. § 1291. We review the district court's factual findings for clear error. Fed.R.Civ.P. 52(a); *SEC v. Rubera,* 350 F.3d 1084, 1094 (9th Cir.2003). As the Supreme Court stated in *TSC Industries, Inc. v. Northway, Inc.,*

> The issue of materiality may be characterized as a mixed question of law and fact, involving as it does the application of a legal standard to a particular set of facts. In considering whether summary judgment on the issue is appropriate, we must bear in mind that the underlying objective facts, which will often be free from dispute, are merely the starting point for the ultimate determination of materiality. The determination requires delicate assessments of the inferences a "reasonable shareholder" would draw from

> a given set of facts and the significance of those inferences to him, and these assessments are peculiarly ones for the trier of fact. Only if the established omissions are "so obviously important to an investor, that reasonable minds cannot differ on the question of materiality" is the ultimate issue of materiality appropriately resolved "as a matter of law" by summary judgment.

426 U.S. 438, 450, 96 S.Ct. 2126, 48 L.Ed.2d 757 (1976) (footnotes omitted).

III. The Final Prospectus Contained Misleading Statements

Section 12(a)(2) of the Act imposes civil liability on

> [a]ny person who . . . offers or sells a security . . . by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission. . . .

15 U.S.C. § 77*l*(a)(2). Thus, to prevail under Section 12(a)(2), a plaintiff must demonstrate (1) an offer or sale of a security, (2) by the use of a means or instrumentality of interstate commerce, (3) by means of a prospectus or oral communication, (4) that includes an untrue statement of material fact or omits to state a material fact that is necessary to make the statements not misleading. The district court noted, and the parties do not dispute, that only the fourth element is at issue here.

A.

We must therefore first determine whether the Final Prospectus contains false or misleading statements or omissions. We have recognized that statements literally true on their face may nonetheless be misleading when considered in context, warning:

> [A]n issuer's public statements cannot be analyzed in complete isolation. "Some statements, although literally accurate, can become, through their context and manner of presentation, devices which mislead investors. For that reason, the disclosure required by the securities laws is measured not by literal truth, but by the ability of the material to accurately inform rather than mislead prospective buyers."

In re Convergent Tech. Sec. Litig., 948 F.2d 507, 512 (9th Cir.1991) (quoting *McMahan & Co. v. Wherehouse Entm't, Inc.*, 900 F.2d 576, 579 (2d Cir.1990));

see also Kaplan v. Rose, 49 F.3d 1363, 1372 (9th Cir.1994).

"Section 12(a)(2) is a virtually absolute liability provision that does not require an allegation that defendants possessed scienter." *In re Suprema Specialties, Inc. Sec. Litig.,* 438 F.3d 256, 269 (3d Cir.2006) (internal quotation marks omitted); *see also Gustafson v. Alloyd Co., Inc.,* 513 U.S. 561, 578, 115 S.Ct. 1061, 131 L.Ed.2d 1 (1995) ("It is understandable that Congress would provide [securities] buyers with a right to rescind, without proof of fraud. . . . "). Moreover, the purchaser need not prove reliance on the misrepresentations. *See Gustafson,* 513 U.S. at 576, 578, 115 S.Ct. 1061.

B.

The disputed statements in the Final Prospectus fall broadly into two categories. Certain representations assert that Thane International expects to have its shares "approved for quotation" on the NASDAQ once the merger is completed and the $5.00 threshold is met. Other representations indicate that Thane International has already secured such approval.

These statements are literally true. Thane International *did* make an effort to have its shares approved for NASDAQ listing, and Thane International *did* actually secure that approval on April 9, 2002, more than two weeks before it filed the Final Prospectus. The disputed statements in the Final Prospectus by their terms promise no more than that.

Yet, as the district court recognized, literal truth is not the standard for determining whether statements in a prospectus are misleading. We held in *Convergent Technologies* that "'[s]ome statements, although literally accurate, can become, through their context and manner of presentation, devices which mislead investors.'" 948 F.2d at 512 (quoting *McMahan,* 900 F.2d at 579). Plaintiff class contends that the Final Prospectus implied that Thane International would *actually* list its shares on the NASDAQ. We agree with the Plaintiff class. The fair and reasonable implication an ordinary investor would derive from all the listing representations is that, after approval, the shares would be listed on the NASDAQ once the $5.00 threshold was met. The Final Prospectus represented that Thane International shares were expected to be approved for NASDAQ listing, and, in the next breath, that Reliant's shareholders could look forward to being "provide[d] . . . with *greater liquidity* than they have with Reliant common stock trading on the over-the-counter market" (emphasis added). Greater liquidity, *i.e.* greater ability to quickly trade at values reasonable in light of underlying supply and demand, was thus touted as a contemporaneous benefit of the merger. That representation surely suggests a commitment to listing the shares on the NASDAQ – once the $5.00 condition was met (which was immediately upon merger) – for approval alone would do absolutely nothing to increase a stock's liquidity. It is only once the stock actually trades on a national market that liquidity would increase. Moreover, that portion of the

Final Prospectus favorably compares Thane International stock's future listing with Reliant's current listing on the OTCBB. The clear implication is that Thane International shares would not trade on the OTCBB, but would instead list on the NASDAQ, which is expressly invoked in the first part of the very same sentence.

The district court relied heavily on the "drafting history" in finding that the Final Prospectus was not misleading. It observed that the Initial Prospectus made Thane International's listing on the NASDAQ market a condition to the merger, but that this condition was dropped by the time the Final Prospectus was accepted by the SEC and distributed to Reliant shareholders. The underlying premise of the district court's reasoning is that investors would read not only the effective Final Prospectus, but also previous drafts, would further connect the dots between various passages related to NASDAQ listing, and could *only* conclude that Thane International had not committed to the NASDAQ listing.

We reject that premise for two reasons. First, this premise overlooks the fact that by the time the Final Prospectus was issued, Thane International had already fulfilled the component of this condition over which it had any control: Thane International had applied for and received approval for NASDAQ listing. All that remained as a predicate for listing was for Thane International shares to reach a minimum bid price of $5.00. Second, investors are not generally required to look beyond a given document to discover

what is true and what is not. *See In re Apple Computer Sec. Litig.*, 886 F.2d 1109, 1114 (9th Cir.1989) ("Ordinarily, omissions by corporate insiders are not rendered immaterial by the fact that the omitted facts are otherwise available to the public."); *Dale v. Rosenfeld,* 229 F.2d 855, 858 (2d Cir.1956) ("Availability elsewhere of truthful information cannot excuse untruths or misleading omissions in the prospectus. Readiness and willingness to disclose are not equivalent to disclosure.") (internal quotation marks omitted).[2] We will not presume or require that investors independently seek out prior versions of SEC filings or otherwise familiarize themselves with the "drafting history" of a prospectus. *Cf. Sanders v. John Nuveen & Co., Inc.,* 619 F.2d 1222, 1229 (7th Cir.1980) ("Section 12(2) does not establish a graduated scale of duty depending upon the sophistication and access to information of the customer. A plaintiff under § 12(2) is not required to prove due diligence. All that is required is ignorance of the untruth or omission.") (citations omitted). Therefore, it was error to impute knowledge of the contents of the Initial

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[2] In the context of a "fraud on the market" Rule 10b-5 class action, where reliance is presumed based on the price of a stock, availability to the public of truthful information may be relevant to the extent the stock's price has not actually been skewed by any misrepresentations. However, in an action that does not involve the fraud on the market presumption, that truthful information is available elsewhere does not relieve a defendant from liability for misrepresentations in a given filing or statement. *See Apple Computer,* 886 F.2d at 1114-15.

Prospectus to Reliant shareholders who received the Final Prospectus.[3]

We also emphasize the "context and manner of presentation" of the references to NASDAQ listing. *Convergent Technologies,* 948 F.2d at 512 (quoting *McMahan,* 900 F.2d at 579). The NASDAQ is discussed no fewer than six times throughout the pages of the Final Prospectus, including on the cover page, the contents of which are closely regulated by the SEC. *See* Regulation S-K, 17 C.F.R. § 229.501(b). Indeed, § 229.501(b)(4) required Thane International to disclose whether "any national securities exchange or the Nasdaq Stock Market lists the securities offered." The listing on the national exchange is even cited as one of "Reliant's Reasons for the Merger." Read in context, these repeated references suggest nothing short of actual listing on the NASDAQ.

The clear error standard is a high bar, but "the presumption of correctness that attaches to factual findings is stronger in some cases than in others. The same 'clearly erroneous' standard applies to findings based on documentary evidence as to those based entirely on oral testimony, but the presumption has

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[3] The district court relied on testimony from plaintiffs' expert witness that "people" and "the market" would have paid attention to and absorbed the shifting promise between the Initial and Final Prospectuses. Even accepting this testimony as true, that "people" and "the market" would have noticed the change does not make the statements themselves any less misleading.

lesser force in the former situation than in the latter." *Bose Corp. v. Consumers Union of United States, Inc.*, 466 U.S. 485, 500, 104 S.Ct. 1949, 80 L.Ed.2d 502 (1984) (citation omitted). The district court's misrepresentation findings were based almost entirely on the documentary record – evidence that is more amenable to evaluation by a reviewing court. Specifically, the relevant evidence consisted primarily of the SEC filings themselves and the witnesses' written declarations. After examining the documentary record, we have a "definite and firm conviction that a mistake has been committed." *Easley v. Cromartie*, 532 U.S. 234, 242, 121 S.Ct. 1452, 149 L.Ed.2d 430 (2001) (citation and internal quotation marks omitted). Therefore, we hold that the Final Prospectus contained false and misleading representations as to the NASDAQ listing and that the district court clearly erred in finding otherwise.

IV. The Misleading Statements Were Material

The district court held in the alternative that even if Thane International misrepresented that it would list its shares on the NASDAQ, any such misrepresentations were immaterial. To conclude that the misrepresentations were immaterial, the district court reasoned that Thane International's shares did not decline in value even after the market absorbed the fact that Thane International shares were not trading on the NASDAQ. Although it acknowledged that Thane International shares did not trade on an efficient market, the district court found

by a preponderance of the evidence that those shares had the ability to incorporate the obvious fact of nonlisting into their price.

The district court erred when it considered the movement in share price of a stock that did not trade on an efficient market to determine materiality under the circumstances of this case. Therefore, its conclusion that Thane International's misrepresentations were immaterial is clear error.

Thane International is liable under Section 12(a)(2) only if the misrepresentations in the Final Prospectus were material to the decision of voters to approve the merger. 15 U.S.C. § 77*l*(a)(2) (referring to a prospectus containing "an untrue statement of a material fact or omit[ting] to state a material fact. . . ."). The Supreme Court articulated the standard for materiality in securities actions in *TSC Industries*: "An omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote." 426 U.S. at 449, 96 S.Ct. 2126.[4] Assessing materiality is a "fact-specific inquiry" that "depends on the significance the reasonable investor would place on the withheld or misrepresented information." *Basic Inc. v. Levinson,* 485 U.S. 224, 240, 108 S.Ct. 978, 99 L.Ed.2d 194 (1988). "[T]o fulfill the materiality

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[4] Though *TSC Industries* involved SEC Rule 14a-9, we have adopted its materiality standard in Section 12 actions. *See Casella v. Webb,* 883 F.2d 805, 807-08 (9th Cir.1989).

requirement 'there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the "total mix" of information made available.'" *Id.* at 231-32, 108 S.Ct. 978 (quoting *TSC Indus.*, 426 U.S. at 449, 96 S.Ct. 2126).

The district court received testimony from both sides' experts on the question of materiality. Testifying for Thane International, Bradford Cornell, Professor of Finance at the Anderson Graduate School of Management at the University of California, Los Angeles, minimized the importance investors attach to the market in which a company trades, concluding "value derives from the company itself and not where it trades." He also testified that liquidity is determined by a company's inherent characteristics,[5] not the market on which it trades. He generally regarded listing on the NASDAQ as a cosmetic benefit of secondary importance to investors who focus on a company's fundamentals.

On behalf of the plaintiff class, Candace Preston, founding member of Financial Markets Analysis, LLC, emphasized the benefits that accompany NASDAQ listing as compared to listing on the OTCBB. She declared that NASDAQ stocks generally

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[5] Cornell cited relevant factors such as a company's number of outstanding shares, its public float, market capitalization, analyst coverage, media coverage, number of institutional shareholders, and volatility.

enjoy greater liquidity, and thus reduced spreads,[6] leading to greater investor returns.[7] NASDAQ-listed shares are also exempt from state-by-state "Blue Sky" laws, which require companies offering securities to undergo burdensome registration processes in certain states in addition to the various federal registration requirements. This translates into lower compliance costs, more favorable terms for raising capital, and thus, all things being equal, higher earnings and share prices. NASDAQ-listed shares can also be purchased on margin, *i.e.* purchased with money on loan from a stockbroker. This can lead, all things being equal, to a larger investor base and higher returns.

Preston testified, and Thane International did not dispute, that institutional investors almost universally shun OTCBB stocks, which significantly cuts

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[6] Stocks that are less liquid have greater "spreads" between the bid and ask prices, i.e. the difference between the price buyers are willing to pay and the price sellers are willing to accept. All things being equal, investors enjoy greater returns as the size of a stock's spread diminishes.

[7] The district court credited this testimony, but found that the statistical evidence demonstrated that NASDAQ listing conferred only a small average advantage for liquidity and spreads. It noted one study showing that for stocks switching from the OTCBB to the NASDAQ, the mean decrease in spreads was less than six cents per share, and the mean increase in trading volume was only around 20 percent. The district court also noted the study's finding that spreads fell for approximately 60 percent of the companies switching from the NASDAQ to the OTCBB, but that they actually rose for about 40 percent.

into the base of demand for those shares (thus depressing their price). Preston also testified that OTCBB stocks are not regularly quoted in financial publications like the *Wall Street Journal,* which further decreases their exposure to potential investors and decreases price transparency. She also explained that NASDAQ listing confers a degree of prestige on a stock because of that market's more rigorous listing standards.

Whether a false promise to list shares on a national exchange like the NASDAQ can be a material omission appears to be a question of first impression in our or any of our sister circuits. At least two district courts have suggested that such a misrepresentation is material, however. In *Blasdel,* Mullenix told Blasdel that shares of his corporation would be traded on the New York Stock Exchange. 356 F.Supp. at 925. In fact, the shares were never listed there. *Id.* at 926. The district court concluded that this misrepresentation was material and that Mullenix had therefore violated Section 12 of the Act. *Id.* at 925, 927.[8]

In *KA Investments LDC v. Number Nine Visual Technology Corp.,* KA Investments bought 300 shares

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[8] It is not clear whether shares of the corporation in *Blasdel* were traded on an exchange other than the New York Stock Exchange, or whether they were never listed on any exchange at all. Nevertheless, it is apparent that the district court attached significance to the promise to list the shares on a national exchange.

of Number Nine's preferred stock for $3 million. 2002 WL 31194865, *1, 2002 U.S. Dist. LEXIS 18690 at *4, Fed. Sec. L. Rep.(CCH) P 92,024 (D.Mass. Aug 26, 2002). The purchase agreement stated as a condition that KA Investments could convert those shares into common stock. *Id.* at *1, 2002 U.S. Dist. LEXIS 18690 at *4-5. "KA Investments' strategy was predicated on its ability to then trade Number Nine's common stock on the NASDAQ National Market, where the stock was listed as of March 31, 1999, or on some other comparable market." *Id.* at *1, 2002 U.S. Dist. LEXIS 18690 at *5. Number Nine also represented that it was in compliance with all relevant NASDAQ listing requirements and that it had no reason to foresee that its shares might be delisted from the NASDAQ. *Id.* at *1-2, 2002 U.S. Dist. LEXIS 18690 at *6. Subsequently, it emerged that Number Nine was not in compliance with NASDAQ's listing requirements and its shares were delisted. *Id.* at *4, 2002 U.S. Dist. LEXIS 18690 at *14. Number Nine was given the option to instead list its shares on the NASDAQ Small Cap Market, but it declined to do so. *Id.* at *4-5, 2002 U.S. Dist. LEXIS 18690 at *15 n. 7.

The district court found that Number Nine misrepresented its status with respect to NASDAQ listing. *Id.* at *10, 2002 U.S. Dist. LEXIS 18690 at *34. It then stated: "Neither do the defendants seriously dispute that this misrepresentation concerned a matter of material interest to KA Investments, given its express plan to trade Number Nine's common stock." *Id.* The district court proceeded to discuss

other elements of the plaintiff's Rule 10b-5 action, on the assumption that the materiality requirement was satisfied. *Id.* at *10-14, 2002 U.S. Dist. LEXIS 18690 at *34-44.

Here, the district court found that based on the evidence presented and without regard to the actual performance of Thane International's stock, the fact of NASDAQ listing was "marginally material." *Miller*, 372 F.Supp.2d at 1208. We agree that Thane International's promise to list its shares on the NASDAQ was material. Even accepting as true all of Cornell's testimony, there is no factual dispute between the experts that NASDAQ listing carries objective benefits that directly and positively affect corporate earnings, investor returns, and a stock's pool of potential shareholders. Earnings benefit because NASDAQ-listed companies are not required to comply with the patchwork of Blue Sky laws adopted by the various states. Describing the burden imposed by Blue Sky compliance, SEC Chairman Arthur Levitt explained to the Senate Committee on Banking, Housing, and Urban Affairs:

> While securities markets today are global, issuers and securities firms still must register many securities offerings in 52 separate jurisdictions; satisfy a multitude of separate books and records requirements; and bear the substantial costs of compliance with the overlapping requirements.

The Securities Investment Promotion Act of 1996: Hearings on S. 1815 Before the Senate Comm. on

Banking, Housing, and Urban Affairs, 104th Cong. 32 (1996); *see also* Therese H. Maynard, *The Uniform Limited Offering Exemption: How "Uniform" is "Uniform?" – An Evaluation and Critique of the ULOE*, 36 Emory L.J. 357, 359 (1987) (noting that complying with both federal and Blue Sky requirements involves "substantial" costs and logistical challenges).

Exemption from Blue Sky registration is especially advantageous for a small company, like Thane International, for which fixed compliance costs will factor as a more significant expenditure. A small company unwilling or unable to pay to comply with a state's Blue Sky regulations cannot offer securities within that state, which adversely affects the company's ability to raise capital. *See* Rutheford B. Campbell, Jr., *The Impact of NSMIA on Small Issuers*, 53 Bus. Law. 575, 580 (1998) (noting "the drag on capital formation imposed by state blue sky regulations, especially as concerns small issuers").

Investors also receive advantages because NASDAQ-listed shares have greater liquidity (as Thane International's Final Prospectus stated) and thus have smaller spreads, on average, than shares traded on the OTCBB. Larger spreads entail a larger built-in loss at the time a stock is purchased, which, all things being equal, makes that stock a less attractive investment. The district court found the difference minimal, noting that average spreads are only six cents higher on the NASDAQ than on the OTCBB, and that some stocks actually saw their spreads increase after switching to the NASDAQ. But pennies

count in the world of investing,[9] and even if some stocks fare better on the OTCBB than the NASDAQ, the opposite more often holds.

The evidence also compels the conclusion that NASDAQ listing attracts investors that would not invest in a bulletin board stock. We find particularly significant Preston's uncontested testimony that all but a "very limited number" of institutional investors are prohibited, under their bylaws, from investing in stocks traded on the OTCBB. According to the New York Stock Exchange, 48.3 percent of the total corporate equities in the United States were owned by institutional investors in 2001, the year before the Final Prospectus was sent to Reliant shareholders.[10] Institutional investors control an enormous portion of investment dollars – dollars that could not flow into Thane International shares if they were listed on the OTCBB, thus slashing into the stock's base of demand.

Three other facts suggest that NASDAQ listing may attract a larger pool of investors than listing on the OTCBB. First, NASDAQ-listed shares can be purchased on margin, while shares on the OTCBB cannot. Second, OTCBB shares are not regularly

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[9] Especially for stocks, like Thane International, that trade in a relatively low price range.

[10] *See* New York Stock Exchange, NYSEData.com Factbook: Holdings of Corporate Equities in the U.S. by Type of Institution, *available at* http://www.nysedata.com/nysedata/asp/factbook/viewer_edition.asp?mode=table&key=2673&category=12.

quoted in popular investment periodicals like the *Wall Street Journal,* which may decrease a stock's exposure to potential investors. Third, as Preston testified, NASDAQ listing lends a degree of prestige to a stock because it means the company has met that exchange's more rigorous listing standards. We find this third fact significant in the context of a company which, like Thane International, had not previously traded its shares publicly, so that investors were without an established track record to provide confidence in the company's prospects and management. Under these circumstances, the stamp of NASDAQ approval could very well provide some reassurance to potential investors.

Here, Thane International's prospectus induced Reliant shareholders to vote for the merger in part because the "combined company [would meet] the initial listing requirements of the NASDAQ National Market, which would provide the Reliant stockholders with greater liquidity than they have with Reliant common stock trading on the over-the-counter market." A reasonable Reliant shareholder would have wanted to know that in fact Thane International would not be listed on the NASDAQ, and would not enjoy the greater liquidity Thane International promised. The omission of this information "significantly altered the 'total mix' of information made available" at the time of the vote. *TSC Indus.,* 426 U.S. at 449, 96 S.Ct. 2126. Certainly, Thane believed that fact was important in the total mix of information presented, or it would not have included the

representation in the first place. We believe that reasonable minds cannot differ on the conclusion that Thane International's misrepresentations regarding NASDAQ listing were material to Reliant shareholders' decision to vote for the merger. Therefore, the district court clearly erred by concluding otherwise, particularly in light of the undisputed fact that the newly merged Thane International never did trade on an efficient market.

V. Loss Causation

A Section 12 defendant is liable only for depreciation that results directly from the misrepresentation at issue. *See*15 U.S.C. § 77*l*(b). Because the district court found no misrepresentation, however, it did not reach loss causation. Thane International urges that we should affirm the district court's judgment because the district court's factual findings necessarily establish that there was no loss resulting from any material misrepresentations. Specifically, Thane International argues that the district court's finding that Thane International stock did not react during its first nineteen days of OTCBB listing supports a finding that its failure to list on the NASDAQ was not the direct cause of any loss of value.

Without expressing any opinion as to the strength of this argument, we remand to the district court to address the issue of loss causation in the first instance, following the "general rule [that] 'a federal appellate court does not consider an issue not passed

upon below.'" *Golden Gate Hotel Ass'n v. City & County of San Francisco,* 18 F.3d 1482, 1487 (9th Cir.1994) (quoting *Singleton v. Wulff,* 428 U.S. 106, 120, 96 S.Ct. 2868, 49 L.Ed.2d 826 (1976)).

VI. Conclusion

Thane International's Final Prospectus misrepresented that Thane International shares would be listed on the NASDAQ, and, under the circumstances, that misrepresentation was material. We therefore remand to the district court with instructions to enter judgment in favor of the plaintiffs, to address loss causation, and to conduct further proceedings consistent with this opinion.

REVERSED and REMANDED.

APPENDIX B

508 F.3d 910

United States Court of Appeals, Ninth Circuit.
Howard MILLER, on behalf of himself
and all others similarly situated;
Joseph J. Milkowski, Plaintiffs-Appellants,
v.
THANE INTERNATIONAL, INC.; William F. Hay;
Denise DuBarry-Hay; Kevin J. McKeon;
Mark Taylor, Defendants-Appellees.
No. 05-56043.

Argued and Submitted May 9, 2007.
Filed Nov. 26, 2007.

Joel C. Feffer and Daniella Quitt, Wechsler Harwood LLP, New York, NY, and Lionel Z. Glancy and Peter A. Binkow, Glancy Binkow & Goldberg LLP, Los Angeles, CA, for the plaintiffs-appellants.

Daniel J. Tyukody and Michael C. Tu, Orrick, Herrington & Sutcliffe LLP, Los Angeles, CA, for the defendants-appellees.

Appeal from the United States District Court for the Central District of California; James V. Selna, District Judge, Presiding. D.C. No. CV-03-01031-JVS.

Before: BARRY G. SILVERMAN, KIM McLANE WARDLAW, and JAY S. BYBEE, Circuit Judges.

WARDLAW, Circuit Judge:

Class plaintiffs appeal the district court's judgment, following a bench trial, in favor of Thane International, Inc. and its officers and directors

(collectively, "Thane International") on plaintiffs' action brought under Section 12(a)(2) of the Securities Act of 1933 (the "Act"), 15 U.S.C. § 77*l*(a)(2) and under Section 15 of the Act, 15 U.S.C. § 77*o*, alleging control person liability against individual defendants. We must decide whether Thane International misrepresented to investors that it would list its shares on the NASDAQ National Market System ("NASDAQ"), and if so, whether those misrepresentations were material. The district court answered "no" to both questions. We have jurisdiction under 28 U.S.C. § 1291. We hold that the district court clearly erred when it found that Thane International did not misrepresent that it would list the merged company's shares on the NASDAQ. We also hold that these misrepresentations were material. We therefore reverse and remand for further proceedings.

I. Factual and Procedural Background

This appeal arises out of a merger transaction between Reliant Interactive Media Corporation ("Reliant"), a publicly traded corporation, and Thane International, a privately held corporation. Reliant and Thane International executed an agreement and plan of merger on November 21, 2001, which was amended on December 6, 2001. Under the terms of the agreement, Reliant shareholders would receive 0.3049459 shares of Thane International common stock for each share of Reliant common stock surrendered upon completion of the merger. A wholly owned subsidiary of Thane International would merge with and into Reliant. The separate corporate existence of

the subsidiary would cease, and Reliant would continue as the surviving corporation. Reliant would then become a wholly owned subsidiary of Thane International. Premerger, Reliant stock traded on the Over-the-Counter Bulletin Board ("OTCBB"), while Thane International's stock was not publicly traded.

On January 3, 2002, Thane International filed a combined proxy statement and prospectus (the "Initial Prospectus"), as part of a Registration Statement on Form S-4, with the Securities and Exchange Commission ("SEC"). The stockholder letter accompanying the Initial Prospectus stated that, as a condition to the merger, Thane International shares would be listed for trade on the NASDAQ, or another national exchange:

> It is a condition to the merger that the shares of Thane common stock to be received by stockholders of Reliant in connection with the merger be quoted or listed on the NASDAQ national market or a national securities exchange.

The Registration Statement was amended on February 21, 2002, March 29, 2002, April 23, 2002, and finally, on April 26, 2002, at which point the SEC declared it effective (the "Final Prospectus"). In the meantime, by letter dated April 9, 2002, NASDAQ notified Thane International that its shares were approved for listing on the NASDAQ.

The Final Prospectus omitted the express listing condition found in the Initial Prospectus. Although

there are several references to listing the merged company's stock on the NASDAQ sprinkled throughout the Final Prospectus, those references contained literal representations that the merged company's shares had been approved for trading on the NASDAQ, and not that the shares were actually listed on the NASDAQ. For example, the cover page of the Final Prospectus states:

> The shares of Thane common stock to be received by stockholders of Reliant in connection with the merger have been approved for quotation and trading on the NASDAQ National Market upon completion of the merger, subject to Thane's compliance with the minimum bid price requirements of $5.00 per share.

Under the heading "Reliant's Reasons for the Merger," the Prospectus represents:

> The combined company is expected to meet the initial listing requirements of the NASDAQ National Market, which would provide the Reliant stockholders with greater liquidity than they have with Reliant common stock trading on the over-the-counter market.

Under the heading "Per Share Market Price Information," the Prospectus informed investors:

> The Thane common stock to be issued in connection with the merger has been approved for quotation and trading on the Nasdaq National Market upon the completion of the merger,

> subject to Thane's compliance with the minimum bid price requirements of $5.00 per share.

In the Final Prospectus's section on "QUESTIONS AND ANSWERS ABOUT THE MERGER," the hypothetical investor asks, "Will Reliant continue as a public company if the merger agreement is approved?" The hypothetical investment advisor replies:

> No. Reliant will become a wholly-owned subsidiary of Thane upon the completion of the merger, and Reliant stockholders will become holders of Thane common stock. Thane has received approval for quotation and trading of its common stock on the Nasdaq National Market upon completion of the merger, subject to Thane's compliance with the minimum bid price requirements of $5.00 per share.

The Final Prospectus also included a copy of the Merger Agreement. Section 6.5(b) of the Merger Agreement discussed Thane International's covenant to secure the NASDAQ listing:

> Thane shall use commercially reasonable efforts to cause its outstanding Thane Common Stock immediately after the Merger to be approved for quotation on the Nasdaq National Market System or, in Thane's reasonable discretion another national securities exchange, subject to official notice of issuance, as promptly as practicable after the date hereof, and in any event prior to the Effective Time.

Thane International was required to "compl[y] in all material respects with all covenants" as a condition precedent to Reliant's obligation to consummate the merger. In the April 9, 2002 letter, NASDAQ notified Thane International that it had approved Thane International's listing application. However, in April 2002, members of Thane International's Board of Directors met with their investment bankers, who advised the Board that shareholder value would be maximized if Thane International did not list its common stock on the NASDAQ immediately after the merger, but instead waited to list once a secondary offering of shares was completed. According to William Hay, Thane International's Chairman and Chief Executive Officer, the secondary offering was to be completed as early as mid-July, approximately six weeks after the merger was consummated. During those six weeks, the bankers recommended that Thane International trade its shares on the OTCBB.

On May 20, 2002, Reliant's shareholders approved the merger, which was consummated on May 24, 2002. Thane International stock commenced trading that day over the OTCBB.

Thane International shareholders experienced a wild ride. Between May 24 and June 11, 2002, the reported share price ranged between $8.50 and $7.00.[1] The stock closed at $6.00 on June 24, 2002.

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[1] Plaintiffs calculate the "merger price" – the value of Reliant stock each Reliant shareholder exchanged for each

(Continued on following page)

Thane International reported its Fiscal Year 2002 earnings on June 25, 2002, and the stock closed that day at $5.25. On June 28, 2002, Thane International's closing price sunk below $5.00 per share, and never again closed above $5.00.

On August 14, 2002, Thane International announced its quarterly earnings in its 10-Q filing with the SEC. The results were disastrous, with earnings falling 46 percent over the same quarter the previous year. Apparently, there was a general slump in the industry about this time. This was compounded by the company's failure to find and market the "hit" product it had hoped to find. Thane International's flagship product, an exercise machine called the "AB-Doer," was not flying off the shelves as it once had. The 10-Q stated:

> In May and June of [2002], we met with our investment bankers to discuss an underwritten public offering of our common stock. Our investment bankers advised us that we could potentially obtain more favorable pricing for the public offering if we implemented our move to the NASDAQ National Market in conjunction with the underwritten [secondary] public offering. Over the course of June and July we have been preparing for the

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Thane International share they received as part of the merger – at $6.99 per share, while defendants calculate it at $6.89 per share. We agree with the district court that resolution of this dispute does not affect the outcome of this case.

> public offering, but we have recently concluded that present market conditions are no longer favorable for an underwritten public offering of common stock. As such, we are currently evaluating the listing of our common stock on a national market.

Thane International shares tumbled on the news, closing at $1.95 on August 16, 2002.

In February 2004, Thane International completed a "going-private" transaction in which all Thane International shareholders were bought out at $0.35 per share. The shares had never been listed on the NASDAQ.

Plaintiffs filed an action in the district court, alleging violations of Section 12(a)(2) of the Act, 15 U.S.C. § 77*l*(a)(2), for misrepresentation in connection with a securities offering and of Section 15 of the Act, 15 U.S.C. § 77*o*, for control person liability against individual defendants William Hay; Denise DuBarry-Hay, William Hay's wife and Thane International's Chief Creative Officer; Kevin McKeon, Thane International's Chief Financial Officer; and Mark Taylor, Thane International's Chief Operating Officer and President. Plaintiffs allege that the Final Prospectus contained material misstatements of fact because it implied that Thane International shares would be listed on the NASDAQ. The district court certified the plaintiff class and confirmed Joseph J. Milkowski as the named class representative.

The district court conducted a three-day bench trial. In a Memorandum of Decision, the district court held that the defendants had not violated Section 12(a)(2) of the Act for two reasons. *Miller v. Thane Int'l, Inc.*, 372 F.Supp.2d 1198 (C.D.Cal.2005). First, the district court found that the statements in the Final Prospectus regarding NASDAQ listing were not false or misleading. *Id.* at 1205-06. The court reasoned that the representations in the Final Prospectus were "literally true," in that they did not promise that Thane International shares would actually be listed on the NASDAQ. *Id.* at 1205. Rather, they merely represented that the shares would be or already had been *approved* or *qualified* for NASDAQ listing. *Id.* at 1204. The district court contrasted this representation with that determined to be false in *Blasdel v. Mullenix*, 356 F.Supp. 924, 925 (W.D.Okla.1971), where the defendant had represented that the corporation's shares "would be listed" on the New York Stock Exchange. *Miller*, 372 F.Supp.2d at 1205.

The district court also gave weight to the "drafting history of the Prospectus," finding it "reinforce[d]" his conclusion that the representations are literally true. *Id.* The district court noted that the Initial Prospectus contained an explicit condition that the merger would be completed only if Thane International listed its shares on the NASDAQ, but that the condition had been omitted from subsequent versions of the prospectus – including the Final Prospectus. *Id.* The district court concluded that dropping this

condition demonstrated that Thane International did not actually promise to list its shares on the NASDAQ because "if a condition to list is eliminated, a reasonable investor would infer that there was no promise to list." *Id.*

Second, in the alternative, the district court held that even if the Final Prospectus contained false statements, those statements were not material. *Id.* at 1208-09. After hearing from both sides' experts, the district court considered the movement in Thane International's share price in the aftermath of the merger as a probative indicator of materiality, even though it acknowledged that Thane International's shares did not trade on an efficient market. *Id.* at 1206-11. It held that because Thane International stock did not depreciate immediately following its listing on the OTCBB, even though the market had the ability to incorporate that information into Thane International's share price, the fact of nonlisting on the NASDAQ was not material. *Id.* at 1210-11.

Plaintiff class timely appealed.

II. Jurisdiction and Standard of Review

We have jurisdiction over final judgments of the district court under 28 U.S.C. § 1291. We review the district court's factual findings for clear error. Fed.R.Civ.P. 52(a); *SEC v. Rubera,* 350 F.3d 1084, 1094 (9th Cir.2003). Whether a misrepresentation is material is a "mixed question of law and fact, involving as it does the application of a legal standard to a

particular set of facts." *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 450, 96 S.Ct. 2126, 48 L.Ed.2d 757 (1976). We review mixed questions of law and fact de novo. *Mathews v. Chevron Corp.*, 362 F.3d 1172, 1180 (9th Cir.2004).

III. The Final Prospectus Contained Misleading Statements

Section 12(a)(2) of the Act imposes civil liability on

> [a]ny person who . . . offers or sells a security . . . by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission. . . .

15 U.S.C. § 77*l*(a)(2). Thus, to prevail under Section 12(a)(2), a plaintiff must demonstrate (1) an offer or sale of a security, (2) by the use of a means or instrumentality of interstate commerce, (3) by means of a prospectus or oral communication, (4) that includes an untrue statement of material fact or omits to state

a material fact that is necessary to make the statements not misleading. The district court noted, and the parties do not dispute, that only the fourth element is at issue here.

A.

We must therefore first determine whether the Final Prospectus contains false or misleading statements or omissions. We have recognized that statements literally true on their face may nonetheless be misleading when considered in context, warning:

> [A]n issuer's public statements cannot be analyzed in complete isolation. "Some statements, although literally accurate, can become, through their context and manner of presentation, devices which mislead investors. For that reason, the disclosure required by the securities laws is measured not by literal truth, but by the ability of the material to accurately inform rather than mislead prospective buyers."

In re Convergent Tech. Sec. Litig., 948 F.2d 507, 512 (9th Cir.1991) (quoting *McMahan & Co. v. Wherehouse Entm't, Inc.*, 900 F.2d 576, 579 (2d Cir.1990)); *see also Kaplan v. Rose*, 49 F.3d 1363, 1372 (9th Cir.1994).

"Section 12(a)(2) is a virtually absolute liability provision that does not require an allegation that defendants possessed scienter." *In re Suprema Specialties, Inc. Sec. Litig.*, 438 F.3d 256, 269 (3d Cir.2006)

(internal quotation marks omitted); *see also Gustafson v. Alloyd Co., Inc.*, 513 U.S. 561, 578, 115 S.Ct. 1061, 131 L.Ed.2d 1 (1995) ("It is understandable that Congress would provide [securities] buyers with a right to rescind, without proof of fraud. . . ."). Moreover, the purchaser need not prove reliance on the misrepresentations. *See Gustafson,* 513 U.S. at 576, 578, 115 S.Ct. 1061.

B.

The disputed statements in the Final Prospectus fall broadly into two categories. Certain representations assert that Thane International expects to have its shares "approved for quotation" on the NASDAQ once the merger is completed and the $5.00 threshold is met. Other representations indicate that Thane International has already secured such approval.

These statements are literally true. Thane International *did* make an effort to have its shares approved for NASDAQ listing, and Thane International *did* actually secure that approval on April 9, 2002, more than two weeks before it filed the Final Prospectus. The disputed statements in the Final Prospectus by their terms promise no more than that.

Yet, as the district court recognized, literal truth is not the standard for determining whether statements in a prospectus are misleading. We held in *Convergent Technologies* that "'[s]ome statements, although literally accurate, can become, through their context and manner of presentation, devices which

mislead investors.'" 948 F.2d at 512 (quoting *McMahan*, 900 F.2d at 579). Plaintiff class contends that the Final Prospectus implied that Thane International would *actually* list its shares on the NASDAQ. We agree with the Plaintiff class. The fair and reasonable implication an ordinary investor would derive from all the listing representations is that, after approval, the shares would be listed on the NASDAQ once the $5.00 threshold was met. The Final Prospectus represented that Thane International shares were expected to be approved for NASDAQ listing, and, in the next breath, that Reliant's shareholders could look forward to being "provide[d] . . . with *greater liquidity* than they have with Reliant common stock trading on the over-the-counter market" (emphasis added). Greater liquidity, *i.e.* greater ability to quickly trade at values reasonable in light of underlying supply and demand, was thus touted as a contemporaneous benefit of the merger. That representation surely suggests a commitment to listing the shares on the NASDAQ – once the $5.00 condition was met (which was immediately upon merger) – for approval alone would do absolutely nothing to increase a stock's liquidity. It is only once the stock actually trades on a national market that liquidity would increase. Moreover, that portion of the Final Prospectus favorably compares Thane International stock's future listing with Reliant's current listing on the OTCBB. The clear implication is that Thane International shares would not trade on the OTCBB, but would instead list on the NASDAQ,

which is expressly invoked in the first part of the very same sentence.

The district court relied heavily on the "drafting history" in finding that the Final Prospectus was not misleading. It observed that the Initial Prospectus made Thane International's listing on the NASDAQ market a condition to the merger, but that this condition was dropped by the time the Final Prospectus was accepted by the SEC and distributed to Reliant shareholders. The underlying premise of the district court's reasoning is that investors would read not only the effective Final Prospectus, but also previous drafts, would further connect the dots between various passages related to NASDAQ listing, and could *only* conclude that Thane International had not committed to the NASDAQ listing.

We reject that premise for two reasons. First, this premise overlooks the fact that by the time the Final Prospectus was issued, Thane International had already fulfilled the component of this condition over which it had any control: Thane International had applied for and received approval for NASDAQ listing. All that remained as a predicate for listing was for Thane International shares to reach a minimum bid price of $5.00. Second, investors are not generally required to look beyond a given document to discover what is true and what is not. *See In re Apple Computer Sec. Litig.*, 886 F.2d 1109, 1114 (9th Cir.1989) ("Ordinarily, omissions by corporate insiders are not rendered immaterial by the fact that the omitted facts are otherwise available to the public."); *Dale v.*

Rosenfeld, 229 F.2d 855, 858 (2d Cir.1956) ("Availability elsewhere of truthful information cannot excuse untruths or misleading omissions in the prospectus. Readiness and willingness to disclose are not equivalent to disclosure.") (internal quotation marks omitted).[2] We will not presume or require that investors independently seek out prior versions of SEC filings or otherwise familiarize themselves with the "drafting history" of a prospectus. *Cf. Sanders v. John Nuveen & Co., Inc.,* 619 F.2d 1222, 1229 (7th Cir.1980) ("Section 12(2) does not establish a graduated scale of duty depending upon the sophistication and access to information of the customer. A plaintiff under § 12(2) is not required to prove due diligence. All that is required is ignorance of the untruth or omission.") (citations omitted). Therefore, it was error to impute knowledge of the contents of the Initial Prospectus to Reliant shareholders who received the Final Prospectus.[3]

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[2] In the context of a "fraud on the market" Rule 10b-5 class action, where reliance is presumed based on the price of a stock, availability to the public of truthful information may be relevant to the extent the stock's price has not actually been skewed by any misrepresentations. However, in an action that does not involve the fraud on the market presumption, that truthful information is available elsewhere does not relieve a defendant from liability for misrepresentations in a given filing or statement. *See Apple Computer,* 886 F.2d at 1114-15.

[3] The district court relied on testimony from plaintiffs' expert witness that "people" and "the market" would have paid attention to and absorbed the shifting promise between the Initial and Final Prospectuses. Even accepting this testimony as

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We also emphasize the "context and manner of presentation" of the references to NASDAQ listing. *Convergent Technologies,* 948 F.2d at 512 (quoting *McMahan,* 900 F.2d at 579). The NASDAQ is discussed no fewer than six times throughout the pages of the Final Prospectus, including on the cover page, the contents of which are closely regulated by the SEC. *See* Regulation S-K, 17 C.F.R. § 229.501(b). Indeed, § 229.501(b)(4) required Thane International to disclose whether "any national securities exchange or the Nasdaq Stock Market lists the securities offered." The listing on the national exchange is even cited as one of "Reliant's Reasons for the Merger." Read in context, these repeated references suggest nothing short of actual listing on the NASDAQ.

The clear error standard is a high bar, but "the presumption of correctness that attaches to factual findings is stronger in some cases than in others. The same 'clearly erroneous' standard applies to findings based on documentary evidence as to those based entirely on oral testimony, but the presumption has lesser force in the former situation than in the latter." *Bose Corp. v. Consumers Union of United States, Inc.,* 466 U.S. 485, 500, 104 S.Ct. 1949, 80 L.Ed.2d 502 (1984) (citation omitted). The district court's misrepresentation findings were based almost entirely on the documentary record-evidence that is more amenable to

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true, that "people" and "the market" would have noticed the change does not make the statements themselves any less misleading.

evaluation by a reviewing court. Specifically, the relevant evidence consisted primarily of the SEC filings themselves and the witnesses' written declarations. After examining the documentary record, we have a "definite and firm conviction that a mistake has been committed." *Easley v. Cromartie,* 532 U.S. 234, 242, 121 S.Ct. 1452, 149 L.Ed.2d 430 (2001) (citation and internal quotation marks omitted). Therefore, we hold that the Final Prospectus contained false and misleading representations as to the NASDAQ listing and that the district court clearly erred in finding otherwise.

IV. The Misleading Statements Were Material

The district court held in the alternative that even if Thane International misrepresented that it would list its shares on the NASDAQ, any such misrepresentations were immaterial. To conclude that the misrepresentations were immaterial, the district court reasoned that Thane International's shares did not decline in value even after the market absorbed the fact that Thane International shares were not trading on the NASDAQ. Although it acknowledged that Thane International shares did not trade on an efficient market, the district court found by a preponderance of the evidence that those shares had the ability to incorporate the obvious fact of nonlisting into their price.

The district court erred when it considered the movement in share price of a stock that did not trade

on an efficient market to determine materiality. Therefore, its conclusion that Thane International's misrepresentations were immaterial is error.

Thane International is liable under Section 12(a)(2) only if the misrepresentations in the Final Prospectus were material to the decision of voters to approve the merger. 15 U.S.C. § 77*l*(a)(2) (referring to a prospectus containing "an untrue statement of a material fact or omit[ting] to state a material fact. . . ."). The Supreme Court articulated the standard for materiality in securities actions in *TSC Industries*: "An omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote." 426 U.S. at 449, 96 S.Ct. 2126.[4] Assessing materiality is a "fact-specific inquiry" that "depends on the significance the reasonable investor would place on the withheld or misrepresented information." *Basic Inc. v. Levinson,* 485 U.S. 224, 240, 108 S.Ct. 978, 99 L.Ed.2d 194 (1988). "[T]o fulfill the materiality requirement 'there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the "total mix" of information made available.'" *Id.* at 231-32, 108 S.Ct. 978 (quoting *TSC Indus.,* 426 U.S. at 449, 96 S.Ct. 2126).

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[4] Though *TSC Industries* involved SEC Rule 14a-9, we have adopted its materiality standard in Section 12 actions. *See Casella v. Webb,* 883 F.2d 805, 807-08 (9th Cir.1989).

The district court received testimony from both sides' experts on the question of materiality. Testifying for Thane International, Bradford Cornell, Professor of Finance at the Anderson Graduate School of Management at the University of California, Los Angeles, minimized the importance investors attach to the market in which a company trades, concluding "value derives from the company itself and not where it trades." He also testified that liquidity is determined by a company's inherent characteristics,[5] not the market on which it trades. He generally regarded listing on the NASDAQ as a cosmetic benefit of secondary importance to investors who focus on a company's fundamentals.

On behalf of the plaintiff class, Candace Preston, founding member of Financial Markets Analysis, LLC, emphasized the benefits that accompany NASDAQ listing as compared to listing on the OTCBB. She declared that NASDAQ stocks generally enjoy greater liquidity, and thus reduced spreads,[6]

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[5] Cornell cited relevant factors such as a company's number of outstanding shares, its public float, market capitalization, analyst coverage, media coverage, number of institutional shareholders, and volatility.

[6] Stocks that are less liquid have greater "spreads" between the bid and ask prices, i.e. the difference between the price buyers are willing to pay and the price sellers are willing to accept. All things being equal, investors enjoy greater returns as the size of a stock's spread diminishes.

leading to greater investor returns.[7] NASDAQ-listed shares are also exempt from state-by-state "Blue Sky" laws, which require companies offering securities to undergo burdensome registration processes in certain states in addition to the various federal registration requirements. This translates into lower compliance costs, more favorable terms for raising capital, and thus, all things being equal, higher earnings and share prices. NASDAQ – listed shares can also be purchased on margin, *i.e.* purchased with money on loan from a stockbroker. This can lead, all things being equal, to a larger investor base and higher returns.

Preston testified, and Thane International did not dispute, that institutional investors almost universally shun OTCBB stocks, which significantly cuts into the base of demand for those shares (thus depressing their price). Preston also testified that OTCBB stocks are not regularly quoted in financial publications like the *Wall Street Journal*, which further decreases their exposure to potential investors and decreases price transparency. She also

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[7] The district court credited this testimony, but found that the statistical evidence demonstrated that NASDAQ listing conferred only a small average advantage for liquidity and spreads. It noted one study showing that for stocks switching from the OTCBB to the NASDAQ, the mean decrease in spreads was less than six cents per share, and the mean increase in trading volume was only around 20 percent. The district court also noted the study's finding that spreads fell for approximately 60 percent of the companies switching from the NASDAQ to the OTCBB, but that they actually rose for about 40 percent.

explained that NASDAQ listing confers a degree of prestige on a stock because of that market's more rigorous listing standards.

Whether a false promise to list shares on a national exchange like the NASDAQ is material appears to be a question of first impression in our or any of our sister circuits. At least two district courts have suggested that such a misrepresentation can be material, however. In *Blasdel,* Mullenix told Blasdel that shares of his corporation would be traded on the New York Stock Exchange. 356 F.Supp. at 925. In fact, the shares were never listed there. *Id.* at 926. The district court concluded that this misrepresentation was material and that Mullenix had therefore violated Section 12 of the Act. *Id.* at 925, 927.[8]

In *KA Investments LDC v. Number Nine Visual Technology Corp.*, KA Investments bought 300 shares of Number Nine's preferred stock for $3 million. 2002 WL 31194865 at *1, 2002 U.S. Dist. LEXIS 18690 at *4, Fed. Sec. L. Rep.(CCH) P92,024 (D.Mass.2002). The purchase agreement stated as a condition that KA Investments could convert those shares into common stock. *Id.* at *1, 2002 U.S. Dist. LEXIS 18690 at *4-5. "KA Investments' strategy was predicated on

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[8] It is not clear whether shares of the corporation in *Blasdel* were traded on an exchange other than the New York Stock Exchange, or whether they were never listed on any exchange at all. Nevertheless, it is apparent that the district court attached significance to the promise to list the shares on a national exchange.

its ability to then trade Number Nine's common stock on the NASDAQ National Market, where the stock was listed as of March 31, 1999, or on some other comparable market." *Id.* at *1, 2002 U.S. Dist. LEXIS 18690 at *5. Number Nine also represented that it was in compliance with all relevant NASDAQ listing requirements and that it had no reason to foresee that its shares might be delisted from the NASDAQ. *Id.* at *2, 2002 U.S. Dist. LEXIS 18690 at *6. Subsequently, it emerged that Number Nine was not in compliance with NASDAQ's listing requirements and its shares were delisted. *Id.* at *4, 2002 U.S. Dist. LEXIS 18690 at *14. Number Nine was given the option to instead list its shares on the NASDAQ Small Cap Market, but it declined to do so. *Id.* at *4 n. 7, 2002 U.S. Dist. LEXIS 18690 at *15 n. 7.

The district court found that Number Nine misrepresented its status with respect to NASDAQ listing. *Id.* at *10, 2002 U.S. Dist. LEXIS 18690 at *34. It then stated: "Neither do the defendants seriously dispute that this misrepresentation concerned a matter of material interest to KA Investments, given its express plan to trade Number Nine's common stock." *Id.* The district court proceeded to discuss other elements of the plaintiff's Rule 10b-5 action, on the assumption that the materiality requirement was satisfied. *Id.* at *10-14, 2002 U.S. Dist. LEXIS 18690 at *34-44.

Here, the district court agreed that based on the evidence presented and without regard to the actual performance of Thane International's stock, the fact

of NASDAQ listing would be material, though only "marginally" so. We agree that Thane International's promise to list its shares on the NASDAQ was material. Even accepting as true all of Cornell's testimony, there can be no dispute that NASDAQ listing carries objective benefits that directly and positively affect corporate earnings, investor returns, and a stock's pool of potential shareholders. Earnings benefit because NASDAQ-listed companies are not required to comply with the patch-work of Blue Sky laws adopted by the various states. Describing the burden imposed by Blue Sky compliance, SEC Chairman Arthur Levitt explained to the Senate Committee on Banking, Housing, and Urban Affairs:

> While securities markets today are global, issuers and securities firms still must register many securities offerings in 52 separate jurisdictions; satisfy a multitude of separate books and records requirements; and bear the substantial costs of compliance with the overlapping requirements.

The Securities Investment Promotion Act of 1996: Hearings on S. 1815 Before the Senate Comm. on Banking, Housing, and Urban Affairs, 104th Cong. 32 (1996); *see also* Therese H. Maynard, *The Uniform Limited Offering Exemption: How "Uniform" is "Uniform?" – An Evaluation and Critique of the ULOE,* 36 Emory L.J. 357, 359 (1987) (noting that complying with both federal and Blue Sky requirements involves "substantial" costs and logistical challenges).

Exemption from Blue Sky registration is especially advantageous for a small company, like Thane International, for which fixed compliance costs will factor as a more significant expenditure. A small company unwilling or unable to pay to comply with a state's Blue Sky regulations cannot offer securities within that state, which adversely affects the company's ability to raise capital. *See* Rutheford B. Campbell, Jr., *The Impact of NSMIA on Small Issuers,* 53 Bus. Law. 575, 580 (1998) (noting "the drag on capital formation imposed by state blue sky regulations, especially as concerns small issuers").

Investors also receive advantages because NASDAQ-listed shares have greater liquidity (as Thane International's Final Prospectus stated) and thus have smaller spreads, on average, than shares traded on the OTCBB. Larger spreads entail a larger built-in loss at the time a stock is purchased, which, all things being equal, makes that stock a less attractive investment. The district court found the difference minimal, noting that average spreads are only six cents higher on the NASDAQ than on the OTCBB, and that some stocks actually saw their spreads increase after switching to the NASDAQ. But pennies count in the world of investing,[9] and even if some stocks fare better on the OTCBB than the NASDAQ, the opposite more often holds.

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[9] Especially for stocks, like Thane International, that trade in a relatively low price range.

The evidence also compels the conclusion that NASDAQ listing attracts investors that would not invest in a bulletin board stock. We find particularly significant Preston's uncontested testimony that all but a "very limited number" of institutional investors are prohibited, under their bylaws, from investing in stocks traded on the OTCBB. According to the New York Stock Exchange, 48.3 percent of the total corporate equities in the United States were owned by institutional investors in 2001, the year before the Final Prospectus was sent to Reliant shareholders.[10] Institutional investors control an enormous portion of investment dollars – dollars that could not flow into Thane International shares if they were listed on the OTCBB, thus slashing into the stock's base of demand.

Three other facts suggest that NASDAQ listing may attract a larger pool of investors than listing on the OTCBB. First, NASDAQ-listed shares can be purchased on margin, while shares on the OTCBB cannot. Second, OTCBB shares are not regularly quoted in popular investment periodicals like the *Wall Street Journal,* which may decrease a stock's exposure to potential investors. Third, as Preston testified, NASDAQ listing lends a degree of prestige to a stock because it means the company has met that

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[10] *See* New York Stock Exchange, NYSEData.com Factbook: Holdings of Corporate Equities in the U.S. by Type of Institution, *available at* http://www.nysedata.com/nysedata/asp/factbook/viewer-edition.asp?mode=table&key=2673&category=12.

exchange's more rigorous listing standards. We find this third fact significant in the context of a company which, like Thane International, had not previously traded its shares publicly, so that investors were without an established track record to provide confidence in the company's prospects and management. Under these circumstances, the stamp of NASDAQ approval could very well provide some reassurance to potential investors.

A reasonable Reliant shareholder would have wanted to know where the new Thane International shares would be trading and would have viewed the fact of Thane International's nonlisting "as having significantly altered the 'total mix' of information made available." *TSC Indus.*, 426 U.S. at 449, 96 S.Ct. 2126. We therefore hold that Thane International's misrepresentations regarding NASDAQ listing were material.

V. Loss Causation

A Section 12 defendant is liable only for depreciation that results directly from the misrepresentation at issue. *See* 15 U.S.C. § 77*l*(b). Because the district court found no misrepresentation, however, it did not reach loss causation. Thane International urges that we should affirm the district court's judgment because the district court's factual findings necessarily establish that there was no loss resulting from any material misrepresentations. Specifically, Thane International argues that the district court's finding

that Thane International stock did not react during its first nineteen days of OTCBB listing supports a finding that its failure to list on the NASDAQ was not the direct cause of any loss of value.

Without expressing any opinion as to the strength of this argument, we remand to the district court to address the issue of loss causation in the first instance, following the "general rule [that] 'a federal appellate court does not consider an issue not passed upon below.'" *Golden Gate Hotel Ass'n v. City & County of San Francisco,* 18 F.3d 1482, 1487 (9th Cir.1994) (quoting *Singleton v. Wulff,* 428 U.S. 106, 120, 96 S.Ct. 2868, 49 L.Ed.2d 826 (1976)).

VI. Conclusion

Thane International's Final Prospectus misrepresented that Thane International shares would be listed on the NASDAQ, and, under the circumstances, that misrepresentation was material. We therefore remand to the district court with instructions to enter judgment in favor of the plaintiffs, to address loss causation, and to conduct further proceedings consistent with this opinion.

REVERSED and REMANDED.

APPENDIX C

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UNITED STATES DISTRICT COURT

CENTRAL DISTRICT OF CALIFORNIA

SOUTHERN DIVISION

HOWARD MILLER, on behalf of himself and all others similarly situated, Plaintiff, vs. THANE INTERNATIONAL, INC., WILLIAM F. HAY, DENISE DUBARRY-HAY, KEVIN MCKEON and MARK TAYLOR, Defendants.	Case No. SA CV 03-1031 JVS (SGLx) CLASS ACTION ~~[PROPOSED]~~ **JUDGMENT** Trial Date: April 12, 2005 Courtroom: 10-C Judge: Hon. James V. Selna (Filed Jun. 10, 2005)

JUDGMENT

This action came on for trial before the Court on April 12, 2005, the Honorable James V. Selna, United States District Judge, presiding. The issues have been tried and a *Memorandum of Decision* announcing the verdict and decision of the court, including Findings of Fact and Conclusions of Law, has been ordered.

Based upon the evidence presented at trial, for the reasons set forth in the Court's *Memorandum of Decision*, and for good cause appearing, it is hereby ORDERED, ADJUDGED and DECREED that final judgment is entered in favor of defendants Thane International, Inc. ("Thane"), William F. Hay, Denise DuBarry-Hay, Kevin McKeon and Mark Taylor, and against plaintiff Joseph J. Milkowski and the certified plaintiff class consisting of all persons and entities who acquired Thane's shares pursuant to the merger between a wholly-owned subsidiary of Thane and reliant Interactive Media Corp. ("Reliant") (other than defendants and Reliant's principal stockholders), on all of plaintiffs' claims. Plaintiffs shall take nothing by their complaint, and defendants shall recover their costs to the extent allowable by law.

Dated: 6 10 05

/s/ James V. Selna
HON. JAMES V. SELNA
UNITED STATES
DISTRICT JUDGE

Presented by:

ORRICK, HERRINGTON &
SUTCLIFFE LLP

/s/ Michael Tu
Michael C. Tu

Attorneys for Defendants Thane International, Inc.,
William F. Hay, Denise DuBarry-Hay,
Kevin McKeon and Mark Taylor

[Proof Of Service Omitted In Printing]

APPENDIX D

372 F.Supp.2d 1198

United States District Court, C.D. California.
Howard MILLER, et al. Plaintiffs,
v.
THANE INTERNATIONAL, INC., et al. Defendants.
No. SACV 03-1031JVS.

June 2, 2005.

Daniella Quitt, Joel C. Feffer, Peter W. Overs Jr., Robert I. HarwoodWechsler & Harwood, New York City, Lionel Z. Glancy, Michael M. Goldberg, Peter A. BinkowGlancy & Binkow, Los Angeles, CA, for Plaintiffs.

Colin H. Murray, Baker & McKenzie, San Diego, CA, Daniel J. Tyukody Jr., Jason L. Krajcer, Michael C. Tu, Orrick Herrington & Sutcliffe, Los Angeles, CA, Lawrence H. Davidson, Marshall S. Brenner, Robert M. Mansukhani, Gordon & Rees, San Diego, CA, for Defendants.

Memorandum of Decision

SELNA, District Judge.

This matter came on for trial before the Court on the plaintiffs' single claim for violation of Section 12(a)(2) of the Securities Act of 1933, 15 U.S.C. § 77*l*(a)(2): misrepresentation in connection with a securities offering. On October 27, 2004, the Court certified this case as a class action, and confirmed

Joseph J. Milkowski ("Milkowski") as the named class representative. (Minute Order, Oct. 27, 2004, pp. 3-5.)

The context of this case is a merger transaction in which the shareholders of Reliant Interactive Media Corp. ("Reliant") received shares of Thane International, Inc. ("Thane"). Milkowski and his class members contend that the prospectus distributed to Reliant shareholders contained a material misstatement of fact because Thane did not list its stock on the NASDAQ National Market System ("NMS") following the merger, notwithstanding numerous alleged representations to the contrary. Plaintiff seeks to recover against Thane and against its officers and directors as "control persons" under Section 15 of the 1933 Act (15 U.S.C. § 77o).

I. *Background.*

The following background facts are drawn from the substantial factual stipulations which the parties made in the Pretrial Conference Order.

A. *The Parties.*

The plaintiff class consists of all persons and entities who acquired Thane's shares pursuant to the merger between a wholly-owned subsidiary of Thane and Reliant, other than defendants and Reliant's

principal stockholders. Plaintiff Milkowski is the class representative.[1]

Defendant Thane is a Delaware corporation and markets consumer products related to fitness, health and beauty, and housewares.

There are four individual defendants. William F. Hay ("Hay") is Thane's co-founder and served as Chairman of Thane's Board of Directors and Chief Executive Officer of Thane at all relevant times. Denise DuBarry-Hay ("DuBarry-Hay") is Hay's wife and a co-founder of Thane, and has served as a director and as Chief Creative Officer of Thane at all relevant times. Kevin McKeon ("McKeon") was Thane's Chief Financial Officer at all relevant times. Mark Taylor ("Taylor") was a director and Chief Operating Officer of Thane from May 1992 through December 2001, when he was named President. Each of the individual defendants signed the Registration Statement filed with the Securities and Exchange Commission ("SEC"). The Proxy Statement/Prospectus ("Prospectus") sent to Reliant shareholders to solicit their votes for the merger was a part of the Registration Statement.

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[1] The Court declined to accept the original plaintiff, Howard Miller, as the class representative because he was arguably subject to a defense not typical of class members. (Minute Order, June 14, 2004, pp. 3-4.)

B. *The History of the Transaction.*

Prior to the merger, Reliant's securities traded in an efficient market, and traded on the on NASDAQ's Over-the-Counter Bulletin Board ("OTC-BB"). Prior to the merger, Thane's stock was not publicly traded.

Reliant and Thane executed a definitive merger agreement on November 21, 2001, which was amended on or about December 6, 2001. On November 26, 2001, Reliant and Thane issued a joint press release announcing the merger and its terms: Each Reliant stockholder would receive a 0.3049459 share of Thane common stock for each share of Reliant common stock surrendered upon the merger of Reliant with a wholly-owned subsidiary of Thane. Collectively, the Reliant stockholders would receive approximately 3.5 million shares of Thane common stock.

On January 3, 2002, in connection with the merger, Thane filed with the SEC a combined proxy statement and prospectus, as part of a Form S-4 Registration Statement. The Registration Statement was amended on February 21, 2002, March 29, 2002, April 23, 2002, and once again on April 26, 2002 whereupon it was declared effective by the SEC.

During April 2002, the individual defendants attended a meeting held in New York City with investment bankers and others. At the meeting, Thane was advised by the investment bankers to delay its planned listing on the NMS to coincide with another planned merger and an accompanying secondary offering. The recommendation was that Thane

list on the OTC-BB, where Reliant was listed, until that time.

In connection with the distribution of the Prospectus to Reliant's stockholders, as well as in connection with other aspects of the merger transaction, the means and instrumentalities of interstate commerce and the mails were used, including mailing the Prospectus to Reliant's stockholders on or about April 29, 2002.

On or about May 20, 2002, Reliant's stockholders voted to approve the merger, and the merger was effected shortly thereafter. Each Reliant shareholder received 0.3049459 shares of Thane common stock for each share of Reliant common stock owned immediately prior to the merger. Plaintiffs calculate the "merger price," which is the value of Reliant stock each Reliant shareholder surrendered for each Thane share they received in the merger, at $6.99 per share. Defendants calculate the merger price as $6.89 per share.

C. *Representations in the Prospectus.*

The Prospectus discussed in numerous places the subject of listing the Thane shares on the NMS, beginning with the cover page:

> The shares of Thane common stock to be received by the stockholders of Reliant in connection with the merger have been approved for quotation and trading on the NASDAQ National Market upon completion of the

> merger, subject to Thane's compliance with the minimum bid price requirements of $5.00 per share.[2]

(Ex. 28, p. 2.)[3] Reliant shareholders were told in the "SUMMARY OF PROPOSED MERGER":

> The combined company is expected to meet the initial listing requirements of the NASDAQ National Market, which would provide the Reliant stockholders with greater liquidity than they have with Reliant common stock trading on the over-the-counter market. (*Id.* at 12.)

The Thane common stock to be issued in connection with the merger has been approved for quotation and trading on the NASDAQ National Market upon the completion of the merger, subject to Thane's compliance with the minimum bid price requirements of $5.00 per share. (*Id.* at 14.)

The "QUESTIONS AND ANSWERS ABOUT THE MERGER" section of the Prospectus also focused on NMS listing:

> Q: Will Reliant continue as a public company if the merger agreement is approved?

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[2] Similar statements appear elsewhere. (Ex. 28, p. 102.)

[3] Exhibit 28 is a version of the Prospectus printed from the SEC's EDGAR web site data base. Page numbers refer to the number in the upper right hand corner. For example, page 2, the cover, is shown as Pages 2 of 389.

> A: No. Reliant will become a wholly-owned subsidiary of Thane upon the completion of the merger, and Reliant stockholders will become holders of Thane common stock. Thane has received approval for quotation and trading of its common stock on the NASDAQ National Market upon completion of the merger, subject to Thane's compliance with the minimum bid price requirements of $5.00 per share. (*Id.* at 19.)

Listing also was discussed in the "Reliant Board Considerations" section:

> The combined company is expected to meet the initial listing requirements of the NASDAQ National Market, which would provide the Reliant stockholders with greater liquidity than they have with Reliant common stock trading on the over-the-counter market. (*Id.* at 49.)

As part of the Prospectus, Reliant shareholders were provided a copy of the Merger Agreement. In Section 6.5(b), the Merger Agreement discusses listing under "Covenants of Thane":

> Thane shall use commercially reasonable efforts to cause its outstanding Thane Common Stock immediately after the Merger to be approved for quotation on the NASDAQ National Market System or, in Thane's reasonable discretion another national securities exchange, subject to official notice of issuance, as promptly as practicable after the

> date hereof, and in any event prior to the Effective Time.

(*Id.* at 339.) Thane was required, as a condition precedent to Reliant's obligation to consummate the merger, to have "complied in all material respects with all covenants." (*Id.* at 340, Merger Agreement, Section 7.1(b).)

D. *NMS Approval.*

By letter dated April 9, 2002, NASDAQ notified Thane that it approved Thane's application to list its securities on the NMS, and thus Thane had approval prior to the merger closing. Thane's stock met the minimum $5.00 per share requirement for listing on the NMS when the merger closed. However, Thane's stock was never listed for trading on the NMS.

E. *Post-Merger Trading and Events.*

On May 24, 2002, the Thane-Reliant merger was completed and Thane's shares commenced trading on the OTC-BB. The number of freely tradeable Thane shares on the OTC-BB post-Merger was approximately 1,422,406 shares, or approximately 4% of the 35,323,784 outstanding shares of Thane.

Between May 24, 2002 and June 11, 2002, Thane's reported stock price ranged between $7.00 and $8.50 per share. On June 24, 2002, Thane's reported closing stock price was $6.00 per share, and

on June 25, 2002, Thane's reported closing stock price was $5.25 per share.

Thane announced its earning results for the 2002 fiscal year on June 25, 2002.

On June 25, 2002, nine additional market makers began trading in Thane's stock (for a total of eleven market makers).

On June 28, 2002, Thane's stock price went below $5.00 per share for the first time, and thereafter the closing price stayed below $5.00 per share.

On August 14, 2002, Thane announced its earnings results for the first quarter of the 2003 fiscal year in its Form 10-Q, dated June 30, 2002, which were approximately 46% lower than the earnings for the same quarter in the prior year ($0.07 per share vs. $0.13 per share). The Form 10-Q told investors that Thane was not going to proceed with listing on the NMS:

> In May and June of this year, we met with our investment bankers to discuss an underwritten public offering of our common stock. Our investment bankers advised us that we could potentially obtain more favorable pricing for the public offering if we implemented our move to the NASDAQ National Market in conjunction with the underwritten public offering. Over the course of June and July we have been preparing for the public offering, but we have recently concluded that present market conditions are no

> longer favorable for an underwritten public offering of common stock. As such, we are currently evaluating the listing of our common stock on a national market.

(Ex. 12, p. 12.) From August 13, 2002 through August 16, 2002, the reported closing price of Thane's shares declined from $3.60 reported per share to $1.95 reported per share.

In February 2004, Thane completed a going-private transaction in which Thane's stockholders received $0.35 for each of their shares. Milkowski did not sell any of the Thane shares he received in the merger until Thane's going-private transaction in 2004. Plaintiffs assert that 386,444 shares of Thane stock in the public float were held and never sold between May 24, 2002 and the time of Thane's going-private transaction.

II. *The Trial Testimony.*

Pursuant to the Court's standard order for Bench trials, the direct examination of each witness was received by way of declaration. Each witness was then tendered for cross-examination. To varying degrees, the parties availed themselves of redirect and recross-examination.

A. *Joseph J. Milkowski.*

In 2001, Milkowski purchased 8,000 shares of Reliant in three separate transactions. (Milkowski

Decl., ¶ 5.) The following year he sold 1,500 shares. (*Id.*) At the time of the merger, he owned 6,500 shares which were converted into 1,982 Thane shares. (*Id.*, ¶ 10.) The shares were worth about $14,000. (*Id.*)

Following the merger, Milkowski learned that Thane's shares were not trading on the NMS. (*Id.*, ¶ 11; Milkowski Depo., pp. 62-63.) He made some inquiries of Thane's investor relations person who referred him to Jorge Freeland, a lawyer with Thane's outside counsel. (Milkowski Decl., ¶ 13.) As Milkowski relates:

> Mr. Freeland also advised me that there would be a new development at Thane that would benefit Thane's shareholders in the next four to six weeks. I spoke with Mr. Freeland approximately four weeks later, and he again urged me to be patient. *Mr. Freeland's representations played a role in my decision not to sell my Thane stock at that time.*

(*Id.*; emphasis supplied.) Milkowski realized at the time he could have sold his shares at a profit. (1 Tr. 47.) However, he made an affirmative investment decision to hold his shares:

> After about a month the stock had gone down probably to three dollars, and it was already, you know, a situation where you just take a position, well, when all this is resolved and they start operating their company in the way that they're supposed to, the price will come back. (Milkowski Depo., p. 68.) Milkowski was in for the long haul: "The

> potential for the company was it could do very well. That's why you invest in it, ..."[4] (*Id.*)

When Thane went private in 2004, Milkowski received $.35 a share, or approximately $700, for his holdings. (Milkowski Decl., ¶ 16.)

B. *Individual Defendants.*

On December 5, 2001, the Thane Board of Directors executed a resolution authorizing all steps necessary for the merger and NMS listing. (Ex. 7, pp. 7-2 7-3.) Hay, DuBarry-Hay, and Taylor signed the resolution. (*Id.*, pp. 7-10, 7-11, 7-12.)

Each of the individual defendants testified that they attended a meeting in April 2002 at which Jonathan Weintrab, a representative of the lead underwriter UBS Warburg, recommended that Thane coordinate its NMS listing with an anticipated secondary offering. (Hay Decl., ¶ 4; DuBarry-Hay Decl., ¶ 3; Taylor Decl., ¶ 4; McKeon Decl., ¶ 3.) According to Sami Mnaymneh, the managing partner of Thane's major shareholder and a participant in the meeting, the investment bankers described the deferral strategy as "the ideal scenario." (Mnaymneh Depo., p. 18.) Hay testified that the investment bankers believed that the secondary offering would look more like an

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[4] For reasons set forth below, the Court does not consider whether Milkowski made a "second investment decision" which would bar him from recovering for any misrepresentation.

initial public offering ("IPO"), and would make the securities more attractive to institutional investors. (1 Tr. 63.) The time line presented at the meeting showed an effective date for the registration between late June and late July, depending on SEC reviews. (Ex. 136, pp. 5, 7.)

In their trial declarations, Hay, Taylor, and McKeon each state that he knew when he signed the Registration Statement that Thane would not seek immediate NMS listing, but rather would defer listing in accordance with the strategy outlined by UBS Warburg. (Hay Decl., ¶ 6; Taylor Decl.; ¶ 5; McKeon Decl., ¶¶ 3, 5.) However, at trial, Taylor denied this. (1 Tr. 98.) DuBarry-Hay testified that she learned of this decision only after the merger. (DuBarry-Hay Decl., ¶ 3.)

Hay.

As a member of the Board of Directors, Hay had the ability to control the content of the Prospectus. (1 Tr. 54.)

DuBarry-Hay.

DuBarry-Hay was Thane's Chief Creative Officer during 2002. (DuBarry-Hay Decl., ¶ 1.) Although a Board member, her role in the actual management of the business was relatively minor compared to the roles of the other individual defendants. (*Id.*, ¶ 3.)

Taylor.

During 2002 Taylor was Thane's CEO and president, and also a member of the Board. (Taylor Decl., ¶ 1.) He outlined his duties as overseeing the day-to-day operations of Thane, and specifically denied responsibility for the merger process either in terms of decision-making or drafting the merger documents. (*Id.*, ¶ 3.) He signed the Registration Statement, and believed that his signature was necessary to complete the merger. (1 Tr. 91-92.)

McKeon

McKeon was Thane's Chief Financial Officer. (McKeon Decl., ¶ 1.) McKeon had a major role in the merger transaction. (*Id.*, ¶¶ 2, 6.) He was responsible for 80% of the content of the Prospectus, putting aside product description. (1 Tr. 126.) He was the lead person in handling the details of NMS listing with NASDAQ. (McKeon Decl., ¶ 6.) He contends that he did not play a decision-making role in the decision to defer listing: "[A]s a factual matter it was not my call." (*Id.*, ¶ 3.) He signed the Registration Statement, and believed that his signature was necessary to complete the merger. (1 Tr. 127.)

C. *The Experts.*

The parties both offered expert testimony on the subject of materiality: from Candace L. Preston ("Preston") on behalf of plaintiffs and from Bradford Cornell ("Cornell") on behalf of defendants. Their

testimony is discussed below in light of the substantive elements for a violation of Section 12(a)(2).

III. *The Substance of the Section 12(a)(2) Claim.*

The requirements of Section 12(a)(2) of the 1933 Securities Act are straight forward and undisputed: Plaintiff must show that there was (1) an offer or sale of securities, (2) by use of any means of interstate commerce, (3) through a prospectus or oral communication, (4) which included an untrue statement of material fact or omitted to state a material fact. 15 U.S.C. § 77*l*(a)(2); *Gustafson v. Alloyd Co., Inc.*, 513 U.S. 561, 577-78, 115 S.Ct. 1061, 131 L.Ed.2d 1 (1995). In terms of plaintiffs' *prima facie* case, the only element in dispute is the fourth. Thus, the Court turns to the threshold determination of whether the statements in the Prospectus with regard to NMS listing were false, and if so, whether they were material.

A. Were the Statements in the Prospectus with Regard to Listing on the NMS false?

A careful facial reading of the Prospectus indicates that Thane made only two basic representations concerning NMS listing. First, Thane would use commercially reasonable efforts to cause the shares to be qualified and approved for quotation on the NMS or a national exchange. The clearest expression is in the Merger Agreement which is attached to the Prospectus:

> Thane shall use commercially reasonable efforts to cause its outstanding Thane Common Stock immediately after the Merger *to be approved for quotation* on the NASDAQ National Market System or, in Thane's reasonable discretion another national securities exchange, subject to official notice of issuance, as promptly as practicable after the date hereof, and in any event prior to the Effective Time.

(Ex. 28, p. 339; emphasis supplied.) Second, Thane reported that it had in fact qualified for listing on the NMS subject only to compliance with the NASDAQ $5 minimum-price requirement. The clearest expression is on the cover of the Prospectus:

> The shares of Thane common stock to be received by the stockholders of Reliant in connection with the merger *have been approved for quotation and trading* on the NASDAQ National Market upon completion of the merger, subject to Thane's compliance with the minimum bid price requirements of $5.00 per share.

(Ex. 28, p. 2; emphasis supplied.)

Both representations are literally true: Neither affirmatively states that Thane's shares have or will in fact be listed on the NMS. *Contrast Blasdel v. Mullenix,* 356 F.Supp. 924, 925 (W.D.Okla.1971) (defendant represented "that the stock of the Corporation *would be listed* on the New York Stock

Exchange"; emphasis supplied). The drafting history of the Prospectus reinforces this view.

Plaintiffs' expert Candace Preston testified that the market was absorbing the material in Thane's initial SEC filing and the follow-on amendments. (1 Tr. 158-59; 2 Tr. 187-88.) The initial Prospectus went farther than the above statements, and described actual listing as a condition of the merger:

> It is a condition to the merger that the shares of Thane common stock to be received by stockholders of Reliant in connection with the merger *be quoted or listed* on the NASDAQ national market or a national securities exchange.

(Ex. 100, p. THNE 00368; emphasis supplied.) By the time Amendment 3 issued, the final version of Prospectus distributed to Reliant shareholders, the condition was dropped. (*See* McKeon Decl., ¶ 7.) The Court believes that this would cause an investor to give the statements concerning NMS listing no more than their literal meaning. Said another way, if a condition to list is eliminated, a reasonable investor would infer that there was no promise to list.

Preston testified at trial that the deletion of the condition along with the shift from reporting that qualification would be obtained to the fact that qualification had been obtained somehow confirmed to the market that the stock would be listed on the NMS. (1 Tr. 158.) The Court rejects this logic. The fact that Thane had qualified for listing did not fulfill the

condition in the initial Prospectus, and the significance of the deletion was unchanged by the fact that the stock had been approved for listing.

Preston testified that the language of the Prospectus created the "obvious inference" that Thane would list immediately. (2 Tr. 185; Preston Decl., ¶ 36.) Howard Miller, the original named plaintiff, and Milkowski both testified that they believed on the basis of the Prospectus that listing would be immediate. (Milkowski Decl., ¶ 8; Miller Depo., p. 37.) The Court cannot subscribe to this theory particularly in light of the deletion of listing as a condition of the merger.

The Court is mindful that a literally true statement may be misleading if belied by the context. *Kaplan v. Rose,* 49 F.3d 1363, 1372 (9th Cir.1994); *In re Convergent Technologies Securities Litigation,* 948 F.2d 507, 512 (9th Cir.1991). There is nothing in the Prospectus that can be juxtaposed with the obligation to secure approval which can turn it into an obligation to list, a different task with different requirements. By contrast, in *Kaplan,* one could take Medstone's statement that its lithotripsy system had been "successfully" used, and juxtapose its 18.5% success rate with its competitor's 80% success rate. *Kaplan,* 49 F.3d at 1372. In that light, it was a question of fact whether Medstone's statement amounted to a misrepresentation. That is not the present case.

The Court finds that plaintiffs have failed to show a misrepresentation by a preponderance of the

evidence. The Court affirmatively finds that the statements regarding listing were not false.

B. *Assuming that Thane Represented That It Would in Fact List on the NMS Following the Merger, Was the Representation Material?*

In *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 449, 96 S.Ct. 2126, 48 L.Ed.2d 757 (1976), the Supreme Court set out the test for materiality:

> An omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote. . . . Put another way, there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the "total mix" of information made available.

Accord Basic Inc. v. Levinson, 485 U.S. 224, 231-32, 108 S.Ct. 978, 99 L.Ed.2d 194 (1988); *No. 84 Employer-Teamster Joint Council Pension Trust Fund v. America West Holding Corp.*, 320 F.3d 920, 934 (9th Cir.2003). In making a determination of materiality, *America West* requires a "fact-specific inquiry" which cannot be short-circuited by mere failure of the market to react to the relevant information. (*Id.* at 935.)

The parties and their experts take widely divergent views on the significance of NMS listing. Preston likened the move from the OTC-BB to the NMS as

the corporate equivalent of a major life event such as marriage or the birth of a child. (2 Tr. 212-13.) Thane's expert chose a different analogy, characterizing listing as the equivalent of buying a new car with chrome wheels rather than without – nice but not essential. (2 Tr. 273.) Apart from their conclusions, they both differed on the role of stock price as an indicator of materiality. Preston did not take it into account; Cornell testified that from the standpoint of an economist, reference to price is an essential part of any determination of materiality. (1 Tr. 169; *see* 2 Tr. 217-18; Cornell Decl., ¶ 32.)

1. *Candace L. Preston.*

Preston holds an M.B.A from the Wharton School Finance, University of Pennsylvania, a Chartered Financial Analyst ("CFA") certification from the CFA Institute, and has an extensive background in consulting on various issues which arise in securities cases. (Preston Decl., ¶¶ 2-3, 7.) She has also been received as an expert in a number of federal securities cases and other proceedings. (*Id.*, ¶¶ 8-9.) The Court finds that Preston is well-qualified, and entitled to express an expert opinion on the subject of materiality.

Preston's basic opinion is that the statements in the Prospectus with regard to listing following the merger were "material to investors in Reliant considering whether or not to continue to hold their Reliant shares and exchange them for Thane shares or to sell

them in the open market before the Merger." (*Id.*, ¶ 14.) In forming her opinion, Preston reviewed the Prospectus and related correspondence to investors. (*Id.*, ¶¶ 15-18.) Among other things, the documents described NMS listing as one of the reasons for the merger because the listing would provide greater liquidity for the shares. (*Id.*, ¶ 18.) She explained that greater liquidity "is generally accompanied by greater investor returns." (*Id.*, ¶ 22.) This is so because liquidity reduces the spread between the bid and asked price for shares, and provides the ability to execute incoming orders immediately as well as resiliency, the ability to execute small orders without large changes in the market price. (*Id.*, ¶¶ 23-24.)

She also noted that listing on the NMS results in greater information in the marketplace because *The Wall Street Journal* and similar publications report daily prices on the NMS, but not on the OTC-BB, where Reliant's shares had previously traded. (*Id.*, ¶ 27.) Listing has several other advantages including greater prestige in investors' assessment of the stock because of the NMS's higher standards, the ability to make purchases on margin, and freedom from state "Blue Sky" law.[5] (*Id.*, ¶¶ 28-29.) The failure to list immediately also delayed the number of market

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[5] The testimony of Reliant CEO Tim Harrington validates a number of these considerations, and as he notes in his testimony, the favorable advantages of NMS listing were raised in the preliminary discussions which led to the merger. (Harrington Depo., pp. 24-26, 51.)

makers in Thane's stock. (*Id.*, ¶ 44.) In the first, thirty days after the merger, Thane had only two market makers.[6] (*Id.*, ¶ 47.)

In her analysis, Preston contended that Thane's stock price was not a valid measure of materiality. She noted that Thane initially had only two market makers, Blair and SunTrust, whom she characterized as conflicted or not disinterested. However, she had no basis to contend, and there was no evidence, that either or both of the market makers had manipulated or artificially inflated the stock following its listing on the OTC-BB. (1 Tr. 173-76.) When confronted with the fact nine more market makers came on the scene in late June 2005, she rejected the notion that the breach of a supposedly material promise to list on the NMS would not have deterred their trading in a suspect stock, suggesting unconvincingly that firms would make a market (and a profit) in the stock of even in fraudulent companies. (1 Tr. 176-77.)

Despite her criticism of Thane's efficiency, she testified that the market would give Thane a ten-day grace period within which to list. (Preston Decl., Ex. A, ¶ 50.) She conceded that the market could absorb the fact of Thane's non-listing. (2 Tr. 203-04.)

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[6] Preston also notes the fact that listing was a condition of the merger as one of the factors leading to her materiality opinion. (Preston Decl., ¶¶ 15-17.) However, as noted in the discussion of misrepresentation, that condition was not part of the deal as consummated. (*See* McKeon Decl., ¶ 7.)

2. *Bruce Cornell.*

Thane's expert Bradford Cornell is a Professor of Finance and Director of the Bank of America Center at the Anderson Graduate School of Management at the University of California, Los Angeles. He holds a doctorate from Stanford University in financial economics. He has written extensively, and has been accepted as an expert in at least 14 different litigations. (Cornell Decl., ¶¶ 5-7.) The Court finds Cornell well-credentialed and qualified to express an opinion on materiality.

Cornell analyzed the effect of trading on the NMS versus the OTC-BB from two perspectives: theoretical and empirical. On the theoretical level, Cornell opined that a stock derives its value from an assessment of the company's expected discounted cash flow, and, in his opinion, from the company itself and its inherent characteristics, and not where its stock trades. (*Id.*, ¶ 13.) He similarly expressed the view that a company's liquidity is predominantly driven by its inherent characteristics rather than the market on which it trades. (*Id.*, ¶ 14.) With respect to small companies such as Thane, he identified high volatility, small public float in relationship to the number of outstanding shares, low trading volume, and sparse news and analyst coverage as factors playing a much greater role in liquidity than the market on which the company was listed. (*Id.*) Cornell characterized the effect of where a stock lists as a "second-order effect" which is "quite ancillary." (*Id.*,

¶ 13.) This would suggest that in the abstract the choice of exchange on which to list is not material.

In his empirical analysis, Cornell conducted an event study of Thane's stock from May 24, 2002, the day Thane first traded on the OTC-BB after the merger, through September 23, 2002. As part of the analysis, he established a group of peer companies against which to assess the movement in Thane's stock price, and created a value-weighted index. (*Id.*, ¶¶ 25-26.) He also used the NASDAQ Composite Index as a benchmark for assessing Thane's price movement. Factoring out Thane specific news which affected its price, Cornell found that Thane generally followed the trend of the peer group index and the NASDAQ Composite Index.[7] (*Id.*, ¶¶ 27-28; Exs. 188, 190.)

Focusing on Thane's August 14, 2002 quarterly earnings report, Cornell concluded that the stock was able to impound that (unfavorable) news within 72 hours, notwithstanding the relative complexity of the report. (*Id.*, ¶ 28.) Cornell also noted the stock likely impounded the June 25, 2002 report of a one-time charge of about $10 million. (*Id.*, ¶¶ 34-35.)

Based on his overall analysis, Cornell concluded that Thane shares certainly impounded the effect of non-listing within the first 19 days of trading while it

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[7] Thane's CEO Hay made the same observation. He believed that the stock declined following the merger because the industry was not doing well generally. (Hay Decl., ¶ 7.)

was still above the merger exchange price. (*Id.*, ¶ 28.) In addition, Cornell concluded that impoundment of the fact of non-listing was a one-time event. (*Id.*, ¶¶ 30-31.) In doing so, he rejected Preston's "market credibility" theory.[8] He testified that any confusion associated with whether Thane would list on the NMS would have been cleared up within three days.[9] (2 Tr. 339-40.)

3. *Conclusions re Materiality.*

If the Court considered the issue of listing in a vacuum – that is, without regard to price effects – the Court would find that listing on the NMS is marginally material. To be sure, NMS listing and its attendant benefits are discussed many times in the Prospectus. However, the empirical studies which

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[8] The Court finds that the plaintiffs' attacks on Cornell's credibility fail to diminish the overall value of his opinions. Cornell's prior statement to the effect that event studies tend to bias, or minimize, damage determinations (Ex. 63, pp. 146-47) does not lead to the conclusion that his use of an event study for a different purposes here – to assess the efficiency of Thane stock – is flawed. Cornell's testimony in *Panavision* that price is irrelevant (Ex. 64, ¶¶ 5-13) is reflective of what he viewed as a peculiar fact situation, and not a general expression of economic principles. Here, Cornell relies on general economic principles in emphasizing price as a factor in determining materiality.

[9] Cornell believes that the confusion would have lasted longer if the representation about listing was indefinite as to time. (2 Tr. 339-40.) However, that opinion is irrelevant given plaintiffs' theory that the representation was for immediate listing.

Preston relied upon show that moving from the OTC-BB to the NMS does not always produce a positive effect on spread reduction and increase in volume, two of the major benefits to be achieved by such a move. In a study by Baker and Feldman, the mean difference in spreads was a little less than 6 cents per share, and the mean increase in volume was about 20 percent.[10] (Ex. 43, p. 85 (internal pagination).) However, the results were not uniform. For about 60 percent of the companies the spread was reduced, but for about 40 percent the spread actually increased. (*Id.*, p. 86 (internal pagination).) Changes in volume show almost the same ratio of favorable to unfavorable changes. (*Id.*) In the abstract, Preston could not say that a stock would benefit from transferring from the OTC-BB to the NMS, but she generally thought Thane would. (2 Tr. 225-27.) In this particular case, however, Preston could not say what the result would be for Thane stock in terms of spread and volume, or even whether the changes would be positive.

If the Court factors in the price effect, the Court believes that listing on the NMS was not a material fact. If a stock trades in an efficient market, a failure

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[10] The Court does not attach much significance to the fact that the individual defendants signed a waiver of any requirement to list. (*See* Ex. 5, pp. 5-2 and 5-3.) The signatories were acknowledging compliance with the obligation to use commercially reasonable efforts under Section 6.5(b) of the Merger Agreement to secure qualification for listing. The waiver of any requirement to list on the NMS was a waiver of a phantom obligation: none existed under the Merger Agreement.

of the market to react to the disclosure of news is an indicator that the news is not material. *In re NAHC, Inc. Securities Litigation,* 306 F.3d 1314, 1330 (3d Cir.2002); *Oran v. Stafford,* 226 F.3d 275, 282-83 (3d Cir.2000); *In re Fidelity/Apple Securities Litigation,* 986 F.Supp. 42, 48 (D.Mass.1997). In considering the price effect, the Court needs to address two questions. First, can one even assess the price effect in Thane given that it did not trade in an efficient market? Second, did Thane's stock impound the fact that the stock was not listed on the NMS without a change in price?

Judicial consideration of efficient market theory usually arises in the context of certifying a securities class action based on a fraud-on-the-market theory. *Basic Inc.,* 485 U.S. at 242, 108 S.Ct. 978; *Binder v. Gillespie,* 184 F.3d 1059, 1063-64 (9th Cir.1999). The purpose of the market analysis is to determine if the element of reliance for each class member can be presumed, thus avoiding the necessity of showing each individual investor's reliance, a showing, which if required, would defeat certification. Where the presumption can be made, a significant burden is lifted from the shoulders of those seeking to prosecute on a class basis. In the context of a Rule 23 determination, the trial court is no ordinary fact finder: "Recognizing the important due process concerns of both plaintiffs and defendants inherent in the certification decision, the Supreme Court requires district courts to conduct a rigorous analysis of Rule 23 prerequisites." *Unger v. Amedisys Inc.,* 401 F.3d

316, 320 (5th Cir.2005). In discharging their duties, many courts have looked to the factors enumerated in *Cammer v. Bloom,* 711 F.Supp. 1264, 1286-87 (D.N.J.1989). *E.g., Binder,* 184 F.3d at 1064-65. *Cammer* and its progeny set a very high bar before a finding of market efficiency can be made

The Court perceives its duty to be somewhat different than if it were called to make a class certification. There are no tones of sweeping due process consequences; rather the inquiry here is the same whether the Court were simply analyzing a substantive claim asserted by Milkowski alone or by a class. To do that, the Court proceeds with a preponderance of the evidence standard. While the core inquiry is the same on class certification or the present determination of materiality – whether Thane's stock impounded the fact that it did not list on the NMS without a change in price – the Court need reach its conclusion only by a preponderance of the evidence. The issue is whether the evidence shows that as a matter of fact the stock impounded the price, not whether all of the *Cammer* factors are rigorously met. In taking this tack, the Court admittedly proceeds into unchartered waters. Perhaps because all the market efficiency cases arise in the class certification context, neither the parties nor the Court have identified any cases where a court has found information impounded in less than a fully efficient market.

There are a number of factors which lead the Court to the conclusion that Thane had the ability to impound the fact of non-listing fairly promptly. First,

although neither expert found that Thane's stock traded in an inefficient market (1 Tr. 169; 2 Tr. 315-16),[11] both agreed that Thane stock had the ability to absorb information. (2 Tr. 203, 306-08, 312.) Preston even agreed that Thane stock had the ability to absorb the specific fact that the stock had not listed on the NMS, but she demurred that one could not tell how or when the impoundment occurred. (2 Tr. 204.) Thane's shares clearly absorbed earnings reports. When Thane announced an earnings shortfall on August 14, 2002, the stock dropped over 40% in price over three days.[12] Cornell testified that the time for a stock to impound an event in its price is partly dependent on the complexity of the information. A quarterly statement, such as Thane issued in August 2002, carried a good deal of complexity beyond a simple comparison with prior earnings. By contrast, the failure to list on the NMS after the merger was

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[11] There is little doubt that Thane stock would not meet the tests for an efficient market under *Cammer*. Volume was relatively modest after the merger. For nearly a month, Thane had only one or two market makers. Thane was not followed by any analysts. Thane did not qualify for using SEC Form S-3. The only *Cammer* factor present to any significant degree is the empirical fact that the stock reacted to some events, such as earnings reports.

[12] The fact that the stock dropped about the same percentage as the quarter vs. quarter earnings drop is purely coincidental.

totally transparent.[13] It was a fact which could be absorbed by the market immediately.

Second, the stock price reacted to events generally in the market and in the peer group identified by Cornell. This can be seen graphically in Exhibits 188 and 190. This is a further indicator that the stock had the ability to impound market information. This pattern negates the notion that stock price simply represented a random walk divorced from information available to the market.

Third, it is significant that Reliant, which traded on the OTC-BB immediately prior to the merger, traded in an efficient market.[14] To be sure, Thane represented a new product mix with new management, but it was not an entity unknown to the marketplace, such as an IPO.

Fourth, there was never any inability to sell shares into the market following the merger. Nor was there any rush to dump Thane shares. (2 Tr. 212.)

Fifth, at least as reflected in internet bulletin board postings, the fact of non-listing was known fairly promptly to those who followed the Raging Bull website. (Ex. 22, *e.g.*, Msg. 261, May 25, 2002.)

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[13] As Miller testified, "[a]ny idiot" can tell where a stock trades by simply looking. (Miller Depo., p. 60.) Cornell characterized the fact as "open and obvious to the market as soon as Thane began trading." (Cornell Decl., ¶ 23.)

[14] The parties stipulated to this fact in the Pre-Trial Conference Order (¶ 5(g)).

As discussed above, Preston contended that price was not a reliable indicator because the market makers were interested, or biased, because they had an eye on acting as investment bankers for the secondary offering which Thane contemplated. There are two difficulties with this theory. First, there is no evidence that the market makers manipulated the stock, and Preston so conceded. Second, the market maker serves only to match buy and sell orders, and has no separate duty, as a specialist would, to keep an orderly market or otherwise stabilize prices. (2 Tr. 338.)

Thus, the question is what the Court is to make of Thane's trading history in the days following the merger. For 19 days, until June 11, 2002, the stock traded at or above its imputed price as of the merger, $7.00,[15] and even rose to $8.50. The Court agrees with Preston that because of the characteristics of Thane's stock, one cannot pinpoint when any given piece of information would be impounded by the stock. Nevertheless, the Court finds by a preponderance of the evidence that the period prior to June 11, 2002 was adequate time to impound the fact of the non-listing in the stock price, but the stock failed to react. This negates a finding of materiality, and confirms the

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[15] Plaintiffs assert that the imputed price was $6.89; defendants assert it was $6.99. The Court uses the $7.00 for simplicity.

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view that the Court's finding of marginal materiality in the abstract was overly generous.

In view of the Court's findings on the threshold determinations of misrepresentation and materiality, there is no need to address loss causation, the liability of the individual defendants, or the various affirmative defenses which Thane has advanced.[16]

IV. *Findings of Fact and Conclusion of Law.*

Based on the foregoing, the Court makes the following findings of facts and conclusions of law.

A. *Findings of Fact.*

1. The Prospectus did not contain a false statement with regard to whether Thane would list its stock on the NMS immediately following the merger of Thane and Reliant.

2. Assuming the Prospectus could be read in a manner to support the conclusion that a false statement had been made with regard to listing, the statement was not material.

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[16] The Court notes Thane's Request for Judicial Notice, filed April 12, 2005. The Court is not certain of the significance of the statement by plaintiffs' counsel to the effect that Thane's price is meaningless. In any event, the Court need not consider the Request in light of its decision on the threshold issues on the basis of the trial record.

B. *Conclusions of Law.*

1. The Court has jurisdiction over this action. 15 U.S.C. § 77v; 28 U.S.C. § 1331.

2. Neither Thane nor the individual defendants violated Section 12(a)(2) of the 1933 Securities Act.

Thane is directed to submit a proposed judgment in conformance with this Memorandum.

APPENDIX E

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UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA
SOUTHERN DIVISION

HOWARD MILLER, on behalf of himself and all others similarly situated, Plaintiff, vs. THANE INTERNATIONAL, INC., WILLIAM F. HAY, DENISE DUBARRY-HAY, KEVIN MCKEON and MARK TAYLOR, Defendants.	Case No. SA CV 03-1031 JVS (SGLx) CLASS ACTION **FINAL PRETRIAL CONFERENCE ORDER** Pretrial Conf.: March 28, 2005 Trial Date: April 12, 2005 Courtroom: 10-C Judge: Hon. James V. Selna (Filed Mar. 28, 2005)

FINAL PRETRIAL CONFERENCE ORDER

Following pretrial proceedings, pursuant to Rule 16, Fed. R. Civ. P. and L.R. 16, IT IS ORDERED:

1. The parties are:

a. Joseph M. Milkowski, on behalf of himself and all persons and entitles who acquired shares of Thane International, Inc. ("Thane") pursuant to the merger (the "Merger") between a wholly-owned subsidiary of Thane and Reliant Interactive Media Corp. ("Reliant") other than defendants and the principal stockholders of Reliant;

b. Thane;

c. William F. Hay;

d. Denise Dubarry-Hay;

e. Kevin J. McKeon; and

f. Mark Taylor.[1]

Each of these parties has been served and has appeared. All other parties named in the pleadings and not identified in the preceding paragraphs are dismissed.

The pleadings that raise the issues are:

a. Class Action Complaint dated September 23, 2002.

b. First Amended Answer of Thane International, Inc., William F. Hay, Denise Dubarry-Hay, Kevin McKeon, and Mark Taylor dated September 26, 2003.

2. Federal jurisdiction and venue are invoked upon the following grounds:

a. The jurisdiction of this Court is based on Section 22(a) of the Securities Act, 15 U.S.C. § 77v(a) and 28 U.S.C. § 1331 (federal question jurisdiction).

b. Venue is proper in this District pursuant to Section 22 of the Securities Act, Section 27 of the

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[1] Hay, Dubarry-Hay, McKeon and Taylor are also referred to in this Order as the "Individual Defendants."

Exchange Act, and 28 U.S.C. §§ 1391(b) and (c). Many of the acts alleged herein, including the dissemination to the investing public of the misleading statements at issue, occurred in substantial part in this District and the Company's principal corporate offices are located within this District.

3. Plaintiffs estimate the trial to take 2-3 days. Defendants estimate the trial to take 4-6 days.

4. The trial is to be a non-jury trial. At least 5 court days prior to the trial date each counsel shall submit to the Court and opposing counsel the findings of fact and conclusions of law the party expects the Court to make upon proof at the time of trial as required by L.R. 52-1.

5. ***STIPULATED FACTS:***

The following facts are admitted and require no proof:

a. The Class consists of all persons and entities who acquired Thane's shares pursuant to the Merger between a wholly-owned subsidiary of Thane and Reliant, other than defendants and Reliant's principal stockholders. Plaintiff Milkowski is the class representative.

b. Defendant Thane is a Delaware corporation and markets consumer products related to fitness, health and beauty, and housewares.

c. Defendant Hay is Thane's co-founder and served as Chairman of Thane's Board of Directors

(the "Board") and Chief Executive Officer of Thane at all relevant times. Hay signed the Registration Statement (as defined below) of which the Proxy Statement/Prospectus (as defined below) was a part.

d. Defendant Dubarry-Hay is Hay's wife, is a co-founder of Thane and has served as a director and as Chief Creative Officer of Thane at all relevant times. Dubarry-Hay signed the Registration Statement of which the Proxy Statement/Prospectus was a part.

e. Defendant McKeon was Thane's Chief Financial Officer at all relevant times. McKeon signed the Registration Statement of which the Proxy. Statement/Prospectus was a part.

f. Defendant Taylor was a director and Chief Operating Officer of Thane since May 1992 and was named President in December 2001. Taylor signed the Registration Statement of which the Proxy Statement/Prospectus was a part.

g. Prior to the Merger, Reliant's securities traded in an efficient market.

h. Prior to the Merger, Reliant's securities traded on the OTC-BB.

i. Prior to the Merger, Thane's stock was not publicly traded.

j. Reliant and Thane executed a definitive merger agreement on November 21, 2001. The

merger agreement was amended on or about December 6, 2001.

k. On November 26, 2001, Reliant and Thane issued a joint press release announcing the Merger wherein each Reliant stockholder would receive a 0.3049459 share of Thane common stock for each share of Reliant common stock surrendered upon the merger of Reliant with a wholly-owned subsidiary of Thane. Collectively, the Reliant stockholders received approximately 3,532,378 shares of Thane common stock. Pursuant to the Merger, Reliant would continue as a surviving corporation and become a wholly-owned subsidiary of Thane.

l. On January 3, 2002, in connection with the Merger, Thane filed with the Securities and Exchange Commission ("SEC"), a combined proxy statement and prospectus, as part of a Registration Statement, on Form S-4 (the "Proxy Statement/ Prospectus"). The Registration Statement was amended on February 21, 2002, March 29, 2002, April 23, 2002, and once again on April 26, 2002 whereupon it was declared effective by the SEC (the "Registration Statement").

m. By letter dated April 9, 2002, The Nasdaq Stock Market, Inc. notified Thane that it approved Thane's "application to list its securities on The Nasdaq National Market."

n. During April 2002, the individual defendants attended a meeting held in New York City with investment bankers and others. At the meeting,

Thane was advised by the investment bankers to delay its planned listing on the NMS to coincide with another planned merger and an accompanying secondary offering.

o. In connection with the distribution of the Proxy Statement/Prospectus to Reliant's stockholders, as well as in connection with other aspects of the Merger transaction, the means and instrumentalities of interstate commerce and the mails were used, including mailing the Proxy Statement/Prospectus to Reliant's stockholders on or about April 29, 2002.

p. The cover page of the Proxy Statement/Prospectus states as follows:

> The shares of Thane common stock to be received by the stockholders of Reliant in connection with the merger have been approved for quotation and trading on the NASDAQ National Market upon completion of the merger, subject to Thane's compliance with the minimum bid price requirements of $5.00 per share.

q. The section of the Proxy Statement/Prospectus titled "SUMMARY OF PROPOSED MERGER," at page 3, states as follows:

> The combined company is expected to meet the initial listing requirements of the NASDAQ National Market, which would provide the Reliant stockholders with greater liquidity than they have with Reliant common stock trading on the over-the-counter market.

r. The section of the Proxy Statement/ Prospectus titled "SUMMARY OF PROPOSED MERGER," at page 4, also states as follows:

> The Thane common stock to be issued in connection with the merger has been approved for quotation and trading on the Nasdaq National Market upon the completion of the merger, subject to Thane's compliance with the minimum bid price requirements of $5.00 per share.

s. The section of the Proxy Statement/ Prospectus titled "QUESTIONS AND ANSWERS ABOUT THE MERGER," at page 7, states as follows:

> Q: Will Reliant continue as a public company if the merger agreement is approved?
>
> A: No, Reliant will become a wholly-owned subsidiary of Thane upon the completion of the merger, and Reliant stockholders will become holders of Thane common stock. Thane has received approval for quotation and trading of its common stock on the Nasdaq National Market upon completion of the merger, subject to Thane's compliance with the minimum bid price requirements of $5.00 per share.

t. The section of the Proxy Statement/ Prospectus titled "Reliant Board Considerations," at page 25, states as follows:

> The combined company is expected to meet the initial listing requirements of the Nasdaq National Market, which would provide the Reliant stockholders with greater liquidity than they

have with Reliant common stock trading on the over-the-counter market.

u. The section of the Proxy Statement/ Prospectus titled "Price Range Of Common Stock And Dividends," at page 59, states as follows:

> The Thane common stock issued in the merger has been approved for quotation and trading on the Nasdaq National Market, subject to Thane's compliance with the minimum bid price requirements of $5.00 per share.

v. The Merger agreement, dated December 6, 2001 is appended to the Proxy Statement/Prospectus as Appendix A. In Section 6.5(b) thereof, of Article VI entitled "Covenants of Thane," Thane states as follows:

> Thane shall use commercially reasonable efforts to cause its outstanding Thane Common Stock immediately after the Merger to be approved for quotation on the Nasdaq National Market System or, in Thane's reasonable discretion another national securities exchange, subject to official notice of issuance, as promptly as practicable after the date hereof, and in any event prior to the Effective Time.

"Effective Time," as used in Section 6.5(b) of the Merger agreement, means the time the Articles of Merger are filed with the Nevada Secretary of State.

w. Section 7.1(b) of the Merger agreement sets forth, as a condition precedent to Reliant's obligation to consummate the Merger, that "Thane shall

have . . . complied in all material respects with all covenants. . . . "

x. The merger prospectus included a Section on Risk Factors Related to the Merger.

y. The risk factors section of the merger prospectus stated the following risk factors, among others:

> "There has been no prior public market for the Thane common stock, and therefore Reliant shareholders cannot be certain of the market value of the Thane common stock they will receive in the merger. Prior to the merger, there has been no public market for the Thane common stock and there can be no assurance that an active market for the Thane common stock will develop or continue after the closing of the merger. Accordingly no assurance can be given as to the liquidity of the market for the Thane common stock or the price at which any sales of shares of Thane common stock may occur in the future. The price for the Thane common stock will depend, in part, upon a number of factors beyond the control of Thane, including:
>
> - liquidity of the market for the Thane common stock;
> - investor perceptions of Thane;
> - changes in conditions or trends in Thane's industry or publicly traded comparable companies;

- adverse publicity which Thane may suffer; and
- general economic and other conditions."

z. The risk factors section of the merger prospectus also stated: "Sales of a substantial number of shares of Thane common stock in the public market after this offering could depress the market price of Thane common stock."

aa. Thane obtained approval for listing on the Nasdaq National Market prior to the completion of the Merger, and Thane's stock met the minimum $5.00 per share requirement for listing on the Nasdaq National Market until June 28, 2002.

bb. Thane's stock was never listed for trading on the NASDAQ National Market System.

cc. On or about May 20, 2002, Reliant's stockholders voted to approve the Merger and the Merger was effected shortly thereafter.

dd. Plaintiffs calculate the "merger price," which is the consideration that each Reliant shareholder paid for each Thane share they received in the merger at $6.99 per share. Defendants calculate the merger price as $6.89 per share.

ee. Each Reliant shareholder received 0.3049459 shares of Thane common stock for each share of Reliant common stock they owed immediately prior to the Merger.

ff. On May 24, 2002, the Thane-Reliant Merger was completed and Thane's shares commenced trading on the OTC-BB.

gg. The number of freely tradeable Thane shares on the OTC-BB post-Merger was approximately 1,422,406 shares, or approximately 4% of the 35,323,784 outstanding shares of Thane.

hh. Between May 24, 2002 and June 11, 2002, Thane's reported stock ranged between $8.50 and $7.00 per share.

ii. On June 24, 2002, Thane's reported closing stock price was $6.00 per share, and on June 25, 2002, Thane's reported closing stock price was $5.25 per share.

jj. Thane announced its earning results for the 2002 fiscal year on June 25, 2002.

kk. On June 25, 2002, nine additional market makers began trading in Thane's stock (for a total of eleven market makers).

ll. On June 28, 2002, Thane's stock price went below $5.00 per share for the first time, and thereafter the closing price stayed below $5.00 per share.

mm. On August 14, 2002, Thane announced its earnings results for the first quarter of the 2003 fiscal year in its Form 10-Q, dated June 30, 2002, which were approximately 46% lower than the

earnings for the same quarter in the prior year ($0.07 per share vs. $0.13 per share).

nn. From August 13, 2002 through August 16, 2002, the reported closing price of Thane's shares declined approximately 46% from $3.60 reported per share to $1.95 reported per share.

oo. Thane's August 14, 2002 Form 10-Q states: "In May and June of this year, we met with our investment bankers to discuss an underwritten public offering of our common stock. Our investment bankers advised us that we could potentially obtain more favorable pricing for the public offering if we implemented our move to the NASDAQ National Market in conjunction with the underwritten public offering. Over the course of June and July we have been preparing for the public offering, but we have recently concluded that present market conditions are no longer favorable for an underwritten public offering of common stock. As such, we are currently evaluating the listing of our common stock on a national market."

pp. Plaintiffs filed their complaint on September 23, 2002.

qq. In February 2004, Thane completed a going-private transaction in which Thane's stockholder's received $0.35 for each of their shares.

rr. Plaintiff Milkowski never sought to exercise any appraisal rights pursuant to the February 2004 going-private transaction.

ss. Plaintiff Milkowski did not sell any of the Thane shares he received in the Merger until Thane's going-private transaction in 2004.

tt. Plaintiffs assert that 386,444 shares of Thane stock in the public float were held and never sold between May 24, 2002 and the time of Thane's going-private transaction.

6. Plaintiffs believe the following non-stipulated facts are undisputed:

a. Defendant Hay's position with Thane provided him with access to non-public information about Thane's and Reliant's businesses, finances, and prospects.

b. Because of Defendant Dubarry-Hay's position, she had access to non-public information about Thane's and Reliant's businesses, finances, and prospects.

c. Because of Defendant McKeon's positions with Thane, he had access to non-pubic information about Thane's and Reliant's businesses, finances, and prospects.

d. Because of Defendant Taylor's positions with Thane, he had access to non-public information about Thane's and Reliant's businesses, finances, and prospects.

e. In the first half of 2000, defendants Hay, Kevin Harrington, Chief Executive Officer of Reliant, and Sami Mnaymneh, representing H.I.G. Capital

Partnership II, L.P., Thane's largest stockholder, had several discussions regarding a possible merger of Reliant and Thane. At the close of these discussions, the parties agreed that there was no immediate opportunity for the two companies to merge.

f. In October 2001, at an Electronic Retailing Association Convention in Las Vegas, representatives of both companies met again and agreed that further discussions about a possible merger would be warranted.

g. On October 23, 2001, in a telephone conversation between Defendant Hay and Kevin Harrington, Harrington advised Hay that Reliant was pursuing several options including an application for listing Reliant stock on the American Stock Exchange and a proposed $15-$25 million equity investment by a New York financier.

h. By letter dated April 9, 2002, the Nasdaq Stock Market, Inc. requested from Thane the payment of the balance of the entry fee. The accompanying Entry Fee Payment Form advised Thane that entry fees due in connection with initial listing applications must be paid in full prior to the admission of a security to trading.

i. On May 16, 2002, four days before Reliant stockholders were scheduled to meet to vote on the Merger, Thane's counsel e-mailed Reliant counsel providing Reliant counsel with "a revised draft of the NASDAQ waiver letter to be signed by Reliant and

each of the Reliant stockholders party to the Merger agreement."

j. The "NASDAQ waiver letter" accompanying such e-mail is dated May 20, 2002 (the date of the Reliant stockholders' meeting), which was addressed to Reliant and Reliant principal stockholders (Messrs. Kevin Harrington, Timothy Harrington, and Mel Arthur) informed them that Thane has been advised by its financial advisors that it is not currently in Thane's best interest to commence trading of the Thane Common Stock on the Nasdaq National Market System . . . " and required that the signatories "waive further performance by Thane of any of its obligations and duties set forth in Section 6.5(b) of the Merger Agreement."

k. Nowhere in the Risk Factors section of the Prospectus did Thane disclose anything concerning the possibility of Thane's failure to list on the NMS.

l. In Thane's June 25, 2002 announcement concerning its 2002 fiscal year results, there is no discussion concerning the market over which Thane's shares were or would be trading.

m. The Declaration of Bradford Cornell, dated January 15, 2004, states: "I never made any assumption regarding market efficiency for Thane stock in either my Expert Report or my Rebuttal Report."

n. At his deposition, Bradford Cornell testified: "Once you get under about four or five dollars, the returns become very volatile simply because of the low nature of the stock price, and there is going to be lots of days with big returns, and you won't have a clue why."

o. August 14, 2002 was the first time investors became aware that Thane had made the decision not to list its shares on the NMS. . . ."

7. Defendants believe the following non-stipulated facts are undisputed:

a. Prior to the Merger, plaintiffs were aware of the risk that the benefits sought to be achieved in the merger may not have been achieved.

b. An affirmative vote of a simple majority of Reliant's shares was required for Reliant to approve the Thane-Reliant merger.

c. The Prospectus informed Reliant's shareholders that Reliant insiders holding more than a majority of the outstanding voting shares (62.69% of total voting power of Reliant's common stock) had contractually agreed to vote in favor of the Thane-Reliant merger pursuant to a voting agreement, and these insiders voted in favor of the merger.

d. Those Reliant insiders comprising 62.69% of total voting power of Reliant's common stock voted in favor of the Thane-Reliant merger pursuant to a voting agreement.

e. Plaintiffs assert that between May 24, 2002 and June 14, 2002, approximately 58,900 shares of Thane stock were sold, and that these shares suffered no damages.

f. Plaintiffs assert that the market "gave Thane approximately ten calendar days" (i.e., from May 24, 2002 when Thane began trading until approximately June 4, 2002) to list on the NMS after the completion of the Merger.

g. Plaintiffs assert that on June 25, 2002, "Thane's chances of a NMS listing were quickly evaporated as a result of the lack of disclosure regarding its failure to list on the NMS."

h. Plaintiff Howard Miller did not sell any of the Thane shares he received in the merger until November 12, 2003.

i. The measure of damages in this case without taking into account the defendants' loss causation defense, is the difference between the merger price (the $6.89 or $6.99 consideration each Reliant shareholder paid for each Thane share they received in the merger) and the amount they received when they sold or disposed of the stock. The measure of damages in this case taking into account defendants' loss causation defense is the difference between the merger price (the consideration paid for the stock) and the price of the stock when the information regarding the alleged misrepresentation was impounded in the stock.

j. Plaintiffs assert that because Thane's stock was not trading efficiently, the reported trading prices of Thane's stock are irrelevant and meaningless.

k. Bradford Cornell's statement quoted at Plaintiffs Fact No. 6(m) is incomplete and quoted out of context. As Cornell states in that declaration, he prepared his declaration in response to plaintiffs' allegation that Cornell "wrongly stated that I tacitly assumed the market for Thane stock was efficient in my reports." In fact, Cornell's declaration makes clear that his analysis concluded that Thane's stock responded accurately to Market and industry factors and news announcements.

l. Bradford Cornell's deposition testimony quoted at Plaintiffs Fact No. 6(n) is incomplete and quoted of context. Immediately prior to the quoted statement in his deposition transcript, Cornell specifically states that in this case he did not intentionally did not use measures of market sensitivities (i.e., beta factors); rather, he used a comparable company approach as part of his analysis.

8. The following facts, though stipulated, shall be without prejudice to any evidentiary objection (LIST FACTS NOT TO BE CONTESTED ALTHOUGH NOT ADMITTED, IF ANY): None.

9. ***PLAINTIFFS CLAIMS***

a. *PLAINTIFF'S CLAIM UNDER SECTION 12(A)(2), 15 U.S.C. §771(A)(2), AGAINST THANE*

The ultimate facts required to establish this claim are:

1. Thane sold or offered to sell a security through a prospectus that used the instrumentalities of interstate commerce;

2. Thane sold, offered to sell, or actively solicited the sale of the stock to the plaintiffs;

3. The sale occurred by means of a prospectus that misstated facts or omitted facts that were necessary to keep the statements that were made from being misleading;

4. The misstatements or omissions were material.

The following evidence will be proffered to establish the ultimate facts listed above:

With regard to subsection (1) above, the following evidence:

i) Admitted fact in 5(o).

With regard to subsection (2) above, the following evidence:

i) Testimony of Joseph J. Milkowski;

ii) Trial Exhibit No. 2.

With regarding to subsection (3) above, the following evidence:

i) Testimony of Defendant Hay;

ii) Testimony of Defendant Dubarry-Hay;

iii) Testimony of Defendant McKeon;

iv) Testimony of Defendant Taylor.

With regard to subsection (4) above, the following evidence:

i) Testimony of Joseph J. Milkowski;

ii) Testimony of Plaintiffs' expert;

iii) Trial Exhibits Nos. 2, 5, 42 and 52-58.

b. *PLAINTIFFS' CLAIM UNDER SECTION 15, 15 U.S.C. §770, AGAINST THE INDIVIDUAL DEFENDANTS*

The ultimate facts required to establish this claim are:

1. Thane violated Section 12(a)(2).

2. Each of the Individual Defendants by reason of their positions had the power and authority to control or influence Thane, and

3. Each of the Individual Defendants were culpable participants in Thane's violation of Section 12(a)(2).

The following evidence will be proffered to establish the ultimate facts listed above:

With regard to subsection (1) above, all of the evidence proffered in connection with Plaintiffs' claim under Section 12(a)(2) listed above will be proffered.

With regard to subsection (2) above, the following evidence:

i) Testimony of Defendant Hay;

ii) Testimony of Defendant Dubarry-Hay;

iii) Testimony of Defendant McKeon;

iv) Testimony of Defendant Taylor;

v) Trial exhibit Nos. 2, 136 and 139.

With regard to subsection (3) above, the following evidence:

i) Testimony of Defendant Hay;

ii) Testimony of Defendant Dubarry-Hay;

iii) Testimony of Defendant McKeon;

iv) Testimony of Defendant Taylor;

v) Trial Exhibits Nos. 2, 14-1, 14-2, 15, 59, 114, 117, 123, 124 and 138.

c. *Defendants' Response to Plaintiffs' Statement*:

Plaintiffs' recitation of the ultimate facts for their Section 12(a)(2) claim omits an important element for which plaintiff has the burden of proof: Section 12(a)(2) also requires that plaintiffs *did not know, and in the exercise of reasonable care could not have known,* of the misstatements or omissions when they purchased the securities. *See In re Itel Sec. Litig.,* 89

F.R.D. 104, 115 (N.D. Cal. 1981) (under Section 12(a)(2), "Plaintiffs also have the burden of proving that they did not know of the untrue statements or omissions when they purchased the securities.").

Plaintiffs' recitation of the ultimate facts for their Section 15 claim omits the requirement that plaintiffs must establish that the Individual Defendants exercised actual power or control to direct or cause Thane to engage in the violation of Section 12(a)(2). *Howard v. Everex Sys., Inc.*, 228 F.3d 1057, 1065 (9th Cir. 2000) ("In order to prove a prima facie case under [the control person statutes], plaintiff must prove: (1) a primary violation of federal securities laws . . . and (2) that the defendant exercised actual power or control over the primary violator"); *In re Homestore.com, Inc. Sec. Litig.*, 347 F. Supp. 2d 790, 809 (C.D. Cal. 2004) (same).

10. ***DEFENDANTS' AFFIRMATIVE DEFENSES AND ADDITIONAL EVIDENCE TO BE RELIED ON IN DEFEATING PLAINTIFFS' CLAIMS***

A. ***Defendants' Affirmative Defenses***

Defendants deny each of plaintiffs' claims and will at trial assert the following affirmative defenses. The evidence listed below is only a general statement of the evidence upon which defendants intend to rely, and defendants reserve the right to offer additional evidence at trial.

1) Affirmative Defenses of Good Faith (No. 2) and that "Defendants did not know and

through the exercise of reasonable care could not have known of the alleged misrepresentation or omission of material fact in the prospectus/proxy statement." (No. 25)

a. Ultimate facts:

Under 15 U.S.C. § 77o, there is no Section 15 control person liability if: "the controlling person had no knowledge of or reasonable ground to believe in the existence of the facts by reason of which the liability of the controlled person is alleged to exist."

As to each individual defendant, defendants will demonstrate that each defendant did not know of and had no reasonable ground to believe in the existence of any misrepresentation or omission in the prospectus.

b. Evidence:

(i) Trial Declarations from each of the individual defendants, to be filed on March 30, 2005;

(ii) Information from the prospectus demonstrating that Hay, DuBarry-Hay, and Taylor all owned substantial number of shares and thus had an interest in maximizing shareholder value;

(iii) Statements in the prospectus indicating a commitment to obtain approval for quotation and trading on the NMS, which was obtained;

(iv) Correspondence between Thane and NASDAQ staff and related documents demonstrating that Thane spent considerable time and effort to obtain approval for quotation and trading on the NMS;

(v) Documents indicating that investment bankers advised Thane on a secondary equity offering and providing timelines for that contemplated offering;

(vi) Deposition testimony and/or trial testimony from Sami Mnaymneh explaining that Thane's investment bankers advised that the NMS listing be coordinated with the secondary equity offering;

(vii) Thane's 10-Q explaining that market events overtook Thane and prevented Thane from completing the secondary offering and listing on the NMS.

2) Affirmative Defenses: Failure to Mitigate Damages (No. 6); Ratification (No. 7); Estoppel (No. 8); Assumption of Risk (No. 9); and Waiver (No. 17).

a) Ultimate Facts:

(i) Failure to Mitigate Damages (No. 6)

"[F]ailure to mitigate damages [is] a possible ground for reducing the amount of the damage award in an appropriate case. . . . Thus, if the plaintiff continues to hold the stock after the discovery of the fraud, he can be deemed to have made a 'second investment decision', based on the 'total mix' of

information now available." *Marbury Management, Inc. v. Kohn*, 470 F. Supp. 509, 517 n.13 (S.D.N.Y. 1979) (citations omitted), *aff'd in part, rev'd in part*, 629 F.2d 705 (2d Cir.), *cert. denied*, 449 U.S. 1011 (1980). Plaintiffs "cannot recover that part of their loss caused by their own failure, once they had reason to know of the wrongdoing, to take reasonable steps to avoid further harm." *In re Valence Tech. Sec. Litig.*, 1996 WL 119468, at *6 (N.D. Cal. 1996) (quoting *Arrington v. Merrill, Lynch, Pierce, Fenner & Smith*, 651 F.2d 615, 620 (9th Cir. 1981)).

As to individual plaintiffs to whom this defense applies, defendants will demonstrate the ultimate facts that the plaintiff knew of the alleged misstatement or omission at a time when he or she could have sold at a profit or minimized his or her damages, but that he or she chose to hold the security instead.

(ii) Ratification (No. 7)

Ratification is a "voluntary election by a person to adopt in some manner as his own an act which was purportedly done on his behalf by another person, the effect of which, as to some or all persons, is to treat the act as if originally authorized by him." *In re Yarom*, 1996 U.S. App. LEXIS 14674, at *4 (9th Cir. 1996) (unpublished) (quoting *Rakestraw v. Rodrigues*, 8 Cal. 3d 67, 73 (1972)). "Since [the other person] is considered to be an agent with authority at the time he performed the act, he does not incur liability for acts done within the scope of that authority." *Rakestraw*, 8 Cal. 3d at 73.

As to individual plaintiffs to whom this defense applies, defendants will demonstrate the ultimate facts that the plaintiff voluntarily elected to hold his or her shares despite his or her knowledge that Thane was trading on the OTC-BB rather than the OTC-NMS, thus ratifying Thane's decision to use its best business judgment as to the timing of any OTC-NMS listing.

(iii) Estoppel (No. 8)

"Four elements must be present to establish the defense of estoppel: (1) The party to be estopped must know the facts; (2) he must intend that his conduct shall be acted on or must so act that the party asserting the estoppel has a right to believe it is so intended; (3) the latter must be ignorant of the true facts; and (4) he must rely on the former's conduct to his injury." *Hecht v. Harris, Upham & Co.*, 430 F.2d 1202, 1208 (9th Cir. 1970) (internal citation and quotation marks omitted).

As to individual plaintiffs to whom this defense applies, defendants will demonstrate the ultimate facts that they should be estopped because they knew of the facts concerning the alleged misrepresentation in the prospectus, that the individual plaintiffs did not inform or seek to inform defendants of their belief that there were alleged misrepresentations and/or that despite their belief they did not sell their stock when they could have at a profit, that defendants were unaware that the individual plaintiffs believed there was an alleged misrepresentation and that the

individual plaintiffs should not now be allowed to claim that they relied on the alleged misrepresentation.

(iv) Assumption of Risk (No. 9)

The affirmative defense of assumption of risk "is available when there has been a voluntary acceptance of a risk and such acceptance, whether express or implied, has been made with knowledge and appreciation of the risk." *Prescott v. Ralphs Grocery Co.*, 42 Cal. 2d 158, 161 (1954); *Bastian v. Petren Resources Corp.*, 892 F.2d 680, 686 (7th Cir. 1990) (affirming dismissal of complaint because plaintiffs "assum[ed] a risk that oil prices might drop unexpectedly").

As to individual plaintiffs to whom this defense applies, defendants will demonstrate the ultimate facts that the plaintiff voluntarily accepted the risk of holding Thane's stock despite his or her knowledge that Thane was trading on the OTC-BB rather than the OTC-NMS and despite his or her assumption of the risks that (i) the price might decline and (ii) Thane might not list on the OTC-NMS.

(v) Waiver (No. 17)

Waiver is "the voluntary or intentional relinquishment of a known right." *Hecht v. Harris, Upham & Co.*, 430 F.2d 1202, 1208 (9th Cir. 1970) (internal citation and quotation marks omitted).

As to individual plaintiffs to whom this defense applies, defendants will demonstrate the ultimate facts that the plaintiff voluntarily held his or her

Thane stock despite his or her knowledge that Thane was trading on the OTC-BB rather than the OTC-NMS, thereby waiving any right to challenge Thane's decision.

b. Evidence:

(i) Plaintiff Miller's deposition testimony indicates that he knew of the alleged misstatements or omissions before and immediately after the merger and that he chose not to sell at a profit when he had the opportunity;

(ii) Plaintiff Milkowski's deposition testimony indicates he knew of the alleged misstatements or omissions immediately after the merger when he could have sold at a profit, but chose not to do so;

(iii) Miller and Milkowski's trading records;

(iv) Miller's deposition testimony indicates he informed clients about the alleged misstatements or omissions after the merger when they had an opportunity to sell at a profit or cut their losses, but these clients made new investment decisions to hold the stock; Miller also claims his clients comprised approximately 5-8% of the total public float of Thane's stock;

(v) Such evidence as may be developed at the individualized proceedings for each particular claimant to follow the primary trial phase, assuming the Court determines liability against any of the defendants and potentially class-wide damages; and

(vi) The same evidence used to demonstrate the loss causation defense on a class-wide basis (see below).

3) Affirmative Defenses: No Causal Connection Between Alleged Misconduct and Alleged Damage (No. 10); Plaintiffs Suffered No Damage (No. 20); Loss Causation (No. 23)

a. Ultimate facts:

The loss causation defense under Section 12(b) provides that there is no liability under Section 12 if,

> the person who offered or sold such security proves that any portion or all of the amount recoverable . . . represents other than depreciation in the value of the subject security resulting from such part of the prospectus or oral communication, with respect to which the liability of that person is asserted. . . .

15 U.S.C. § 771(b).

Defendants will demonstrate the ultimate fact that none of the decline in the value of Thane's stock is attributable to any alleged misstatements or omissions in the prospectus. Alternatively, defendants will demonstrate the ultimate fact that only a limited

portion of the decline in the value of Thane's stock is attributable to any alleged misstatements or omissions in the prospectus.

b. Evidence:

In addition to the evidence demonstrating the lack of any loss causation as to individual plaintiffs (described above), the following evidence demonstrates there were no damages on a class-wide basis:

(i) Cornell's expert report, rebuttal report and his declarations filed previously in this case, and Cornell's Trial Declaration to be filed on March 30, 2005;

(ii) Thane's reported stock prices during the relevant period;

(iii) Comparative price data for the NASDAQ Composite Index and comparative companies;

(iv) Thane's SEC filings during the relevant period;

(v) Thane's press releases and news articles concerning Thane during the relevant period;

(vi) Relevant economic and finance literature as described by Cornell;

(vii) Plaintiffs' responses to defendant's request for admissions;

(viii) Portions of Preston's report, declaration, and back-up data.

4) Affirmative Defense: Forward-Looking Statements

a. Ultimate Facts:

Under the safe harbor provision for forward-looking statements:

> Except as provided in subsection (b), in any private action arising under this title [15 U.S.C. §§ 77a et seq.] that is based on an untrue statement of a material fact or omission of a material fact necessary to make the statement not misleading, a person referred to in subsection (a) shall not be liable with respect to any forward-looking statement, whether written or oral, if and to the extent that –
>
> (A) the forward-looking statement is –
>
> (i) identified as a forward-looking statement, and is accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materiality from those in the forward-looking statements; *or*
>
> (ii) immaterial; *or*
>
> (B) the plaintiff fails to prove that the forward-looking statement –
>
> (i) if made by a natural person, was made with actual knowledge by that person that the statement was false or misleading; or

> (ii) if made by a business entity; was –
>
> (I) made by or with the approval of an executive officer of that entity, and
>
> (II) made or approved by such officer with actual knowledge by that officer that the statement was false or misleading.

15 U.S.C. § 77z-2(c)(1) (emphasis added).

Defendants will prove in the ultimate facts that (A) all of the alleged misrepresentations in the prospectus are identified as forward-looking statements and are accompanied by meaningful cautionary language *and* (B) all of the alleged misrepresentations in the prospectus are forward-looking statements and plaintiffs have failed to prove that the statements were made with actual knowledge (by either Thane or its officers) that the statements were false or misleading.

b. Evidence:

Statements in the prospectus: (i) indicating that Thane "has been approved for quotation and trading" and is "expected to meet the initial listing requirements" of the NMS, (ii) stating that "Thane shall use *commercially reasonable efforts* to cause its outstanding Thane Common Stock immediately after the merger to be *approved for quotation*" on the NMS, and (iii) disclosing various risk factors, including "liquidity of the market for the Thane common

stock. . . ." Defendants will also submit trial declarations of the individual defendants demonstrating that none of them had actual knowledge that any of the forward-looking statements in the prospectus was false or misleading.

5) Affirmative Defense: Equitable Indemnity and Comparative Contribution

a. Ultimate facts:

"California common law recognizes a right of partial indemnity under which liability among multiple tortfeasors may be apportioned according to the comparative negligence of each." *Children's Hospital v. Sedgwick*, 45 Cal. App. 4th 1780, 1786 (1996). "Claims for contribution and indemnity . . . do not accrue . . . until the time of payment." *Great American West, Inc. v. Safeco Ins. Co. of America*, 226 Cal. App. 3d 1145, 1152 (1991).

A right to contribution is also generally available under federal securities law. *Nelson v. Quimby Island Reclamation District Facilities Corp.*, 492 F. Supp. 1364, 1383 (N.D. Cal. 1980). A cause of action for contribution under federal law does not accrue until the party seeking contribution makes a disproportionate payment of liability. *Asdar Group v. Pillsbury, Madison and Sutro*, 99 F. 3d 289, 295 (9th Cir. 1996).

Thus, while any claims for equitable indemnity and comparative contribution are premature at this time, defendants reserve the right to pursue claims for equitable indemnity and comparative contribution

in the event that plaintiffs' claims against defendants result in the payment of any judgment.

6) Affirmative Defense: Knowledge

a. Ultimate facts:

A claimant has no claim under Section 12(a)(2) if when he or she acquired the stock, the stockholder was "knowing of such untruth or omission." 15 U.S.C. § 771(a)(2).

As to individual plaintiffs to whom this defense applies, defendants will demonstrate the ultimate fact that the plaintiff knew of the alleged misstatement or omission before he or she acquired the stock.

b. Evidence:

Defendants intend to offer:

(i) Internet postings in which plaintiff Miller publicly stated to other investors that he knew of Thane's decision not to list on the OTC-NMS before the vote on the merger;

(ii) Miller's deposition testimony;

(iii) Such evidence as may be developed at the individualized proceedings for each particular claimant to follow the primary trial phase.

B. *Additional Evidence That Will Be Relied Upon To Defeat Plaintiff's Claims*

1) *Section 12 Claims*

a. *Existence of a Misstatement*

As to the misstatement/omission element of plaintiffs' Section 12 claims, defendants intend to offer the following evidence to defeat plaintiffs' claims:

(i) The relevant language of the merger prospectus itself;

(ii) Correspondence with NASDAQ staff demonstrating that Thane sought and received approval for quotation and trading of its stock or NMS;

(iii) Declarations from the individual defendants concerning their understanding of the relevant language in the prospectus. Because plaintiffs' claim is based on an implied promise (rather than an express promise), these statements are probative as to the existence of such an implied promise.[2]

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[2] Plaintiffs will be required to demonstrate that defendants had actual knowledge of the falsity of the statements in light of the safe harbor for forward-looking statements. *See In re Dynegy, Inc. Sec. Litig.*, 339 F. Supp. 2d 804, 826 n.5 (S.D. Tex. 2004) (noting at Section 11 claims do not normally require scienter but [a]n exception to the no-scienter-requirement is that under § 27A(c) of the Private Securities Litigation Reform Act (PSLRA), to impose liability on a defendant for 'forward-looking' statements a plaintiff must demonstrate that the speaker or approving officer had actual knowledge of the false or misleading statement made on behalf of the corporation.").

b. *Materiality of the Alleged Misstatement*

As to the materiality element of plaintiffs' Section 12 claims, defendants intend to offer the following evidence to defeat plaintiffs' claims:

(i) The testimony and exhibits contained in the Cornell report, rebuttal report, and declarations previously filed in this case, and the Cornell Trial Declaration to be filed on March 30, 2005;

(ii) The reported stock prices of Thane, including volume and price reports of all transactions in Thane's stock from May 24, 2002 through September 23, 2002;

(iii) Comparative price data for the NASDAQ Composite Index and comparative companies;

(iv) Thane's SEC filings;

(v) Thane's press releases and news articles concerning Thane;

(vi) Economic and finance literature;

(vii) Plaintiffs' responses to defendants' requests for admissions;

(viii) Portions of Preston's report, declaration, and back-up data;

(ix) Portions of Miller's deposition testimony indicating that he knew of the alleged misstatements or omissions before and immediately after the merger and that he chose not to sell at a profit when he had the opportunity,

(x) Portions of Milkowski's deposition testimony indicating that he knew of the alleged misstatements or omissions immediately after the merger when he could have sold at a profit, but chose not to do so;

(xi) Miller's and Milkowski's trading records;

(xii) Portions of Miller's deposition testimony indicating that he informed several of his clients about the alleged misstatements or omissions after the merger when they had an opportunity to sell at a profit or cut their losses, but these clients made new investment decisions to hold the stock.

c. *Existence of Damages*

As to damages for plaintiffs' Section 12 claims, defendants will rely upon the same evidence as to materiality (described above) to defeat plaintiffs' claims.

2) *Control Person Claims*

With respect to plaintiffs' control person claims, defendants will rely upon the same evidence as to plaintiffs' Section 12 claims (described above) to demonstrate there is no underlying violation.

As to the control element of these claims, defendants intend to offer the following evidence to defeat plaintiffs' claims:

(i) Deposition testimony of Hay, DuBarry-Hay, Taylor, and McKeon;

(ii) Trial Declarations of Hay, DuBarry-Hay, Taylor, and McKeon to be filed on March 30, 2005;

(iii) Declaration of DuBarry-Hay filed on December 14, 2004.

C. *Plaintiffs' Response to Defendants' Statement*

Plaintiffs object to Defendants' characterizations of their evidence allegedly supporting their affirmative and other defenses as argumentative and improper. Plaintiffs also object to defendants' recitation of the law concerning their affirmative defenses for the reasons stated in plaintiffs' Memorandum of Contentions of Law and Fact.

11. All discovery is complete.

12. All disclosures under Fed. R. Civ. P. 26(a)(3) have been made. The joint exhibit list of the parties has been filed herewith under separate cover as required by L.R. 16-5. All exhibits may be admitted without objection, except those exhibits listed below:

a. Plaintiffs object to the following exhibits in the joint exhibit list:

1) Documents pertaining to Howard Miller (Exhibits 19-27, 31 and 242-49) on the grounds they are not relevant

2) Bradford Cornell's and Denise DuBarry-Hay's declarations (Exhibits 158, 160 and 157) on the ground

that what they said in previous declarations can be said in their trial declarations.

b. Defendants do not stipulate to the admissibility of the following exhibits in the joint exhibit list:

1) Candace Preston's Updated Report (Exhibit 53).

2) The articles listed as Exhibits 54 to 58. Defendants have not yet received copies of these articles (or bates identification ranges for the articles), so cannot stipulate to their admissibility. Once defendants receive these documents they will make that determination.

13. All disclosures under Fed. R. Civ. P. 26(a)(3) have been made. A joint witness list has been filed with the Court.

14. Each party intending to present evidence by way of deposition testimony has marked such depositions in accordance with L.R. 16-2.7. For this purpose, the following depositions shall be lodged with the Clerk as required by L.R. 32-1:

a. Kevin Harrington (designated by plaintiffs and defendants)

b. Joseph Milkowski (designated by defendants)

c. Howard Miller (designated by defendants)

d. Sami Mnaymneh (designated by plaintiffs and defendants)

e. James Moakley (designated by plaintiffs)

f. Candace L. Preston (designated by defendants)

15. The following law and motion matters and motions *in limine* are pending or contemplated:

a. Defendants' Motion *In Limine* No. 1 Precluding Evidence or Testimony to the Effect That Thane Shareholders Did Not Sell Their Shares Because They Supposedly Believed That Doing So Would Decrease the Stock Price; and

b. Defendants' Motion *In Limine* No. 2 To Phase the Trial.

The parties have stipulated to the following two evidentiary limitations for trial. (In reliance on plaintiffs' stipulation, defendants did not file motions *in limine* on these grounds.) The court hereby orders that unless previously unknown supporting evidence on these matters comes to light at trial,

a. Plaintiffs will not make any assertion, claim or argument that Thane's going-private transaction provided any intention, motivation or reason for any of the defendants' alleged misrepresentations or omissions that plaintiffs claim in this case.

b. Plaintiffs will not make any assertion, claim or argument that defendants or

their employees or attorneys engaged in or caused there to be any individual communications or disclosures with members of the shareholder class regarding any of the issues relevant to the alleged misrepresentations or omissions that plaintiffs claim in this case. This excludes the communications which were previously alleged by Howard Miller and Joseph Milkowski in pre-trial discovery.

16. Bifurcation of the following issues for trial is ordered:

Defendants' Motion *In Limine* No. 2 seeks an order establishing a separate trial phase pertaining to individualized damages, loss causation and knowledge issues in the event that liability is determined against any of the defendants and damages are determined as being potentially available on a class-wide basis. Plaintiffs oppose this motion because it seeks relief inconsistent with the language of Section 12(a)(2) and otherwise for the reasons stated in their memorandum in opposition thereto.

17. The foregoing admissions having been made by the parties, and the parties having specified the forgoing issues of fact and law remaining to be litigated, this pretrial conference order shall supersede the pleadings and govern the course of the trial of this cause, unless modified to prevent manifest injustice.

Dated: 3.28, 2005

/s/ James V. Selna
HON. JAMES V. SELNA
UNITED STATES
DISTRICT JUDGE

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[Proof Of Service Omitted In Printing]

APPENDIX F

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

CIVIL MINUTES – GENERAL

Case No. SACV 03-1031-JVS (SGLx) — Dated: March 3, 2005

Title: HOWARD MILLER v. THANE INTERNATIONAL, INC. et al.

PRESENT: HONORABLE JAMES V. SELNA, UNITED STATES DISTRICT JUDGE

Karla J. Tunis	Not Present
Courtroom Deputy	Court Reporter

ATTORNEYS PRESENT FOR PLAINTIFFS:	ATTORNEYS PRESENT FOR DEFENDANTS:
Not Present	Not Present

PROCEEDINGS: ORDER:

[(In Chambers)] (1) Granting in Part Plaintiffs' Motion for Partial Summary Judgment;
(2) Granting in Part Defendants' Motion for Summary Judgment or Partial Summary Judgment; and
(3) Denying to the Extent it is not Moot Defendant Denise DuBarry-Hay's Motion for Summary Judgment

The Plaintiff Class ("Class") moves this Court for an order pursuant to Federal Rule of Civil Procedure ("Rule") 56 granting partial summary judgment to the Class on all issues other than damages. Defendants Thane International, Inc., William F. Hay ("Hay"), Denise DuBarry-Hay ("DuBarry-Hay"), Kevin McKeon ("McKeon") and Mark Taylor ("Taylor") (collectively "Thane") also move this Court for summary judgment on the issue of materiality and the affirmative defense of loss causation. Alternatively, Thane requests that this Court grant partial summary judgment limiting the class period to the period between May 24, 2002 and June 4, 2002. In addition, defendant DuBarry-Hay seeks summary judgment on separate grounds. The Court denies, in part, and grants, in part, the Class' motion and grants, in part, and denies, in part, Thane's motion. The Court denies DuBarry Hay's motion to the extent that it is not rendered moot due to the Court's ruling on Thane's motion for summary judgment.

Background

On November 21, 2001, Reliant Interactive Media Corp. ("Reliant") and Thane executed a merger agreement. (Class' Rule 56-1 Statement of Uncontroverted Facts and Conclusions of Law in Support of Class' Motion for Partial Summary Judgment [hereinafter "Class UF"], No. 10.) Under the terms of the merger, each Reliant shareholder would receive a 0.3049459 share of Thane common stock for each share of Reliant common stock when Reliant merged

with a wholly-owned subsidiary of Thane. (*Id.*, No. 11.) On January 3, 2002, in connection with the merger, Thane filed with the Securities and Exchange Commission ("SEC") a combined proxy statement and prospectus, as part of a Registration Statement, on Form S-4 ("Proxy Statement/Prospectus"). (*Id.*, No. 12.) The Registration Statement was amended several times over the next several months. (*Id.*) Finally, on April 26, 2002, the SEC declared the Registration Statement effective. (*Id.*)

The Proxy Statement/Prospectus that had been provided to Reliant's shareholders contained several statements that the Thane common stock Reliant shareholders would receive in connection with the merger had been approved or was expected to meet the initial listing requirements for quotation and trading on the Nasdaq National Market ("Nasdaq-NMS") upon completion of the merger. (*Id.*, Nos. 15-20.) Also, in the merger agreement itself, Thane covenanted to "use commercially reasonable efforts to cause its outstanding Thane Common Stock immediately after the Merger to be approved for quotation on the Nasdaq National Market System." (*Id.*, No. 21.)

On May 20, 2002, Reliant's stockholders voted to approve the merger (*id.*, No. 13.) and the merger was effected on May 24, 2002, (Thane's Statement of Uncontroverted Facts and Conclusions of Law in Support of Thane's Motion for Summary Judgment [hereinafter "Thane UF"], No. 8.) The imputed "merger price," or the price that Reliant shareholders received for their stock in the merger, has been

calculated by Plaintiffs to be $6.99 per share (*id.*, No. 10) and by Defendants to be $6.89 per share.[1] (Expert Report of Bradford Cornell [hereinafter "Cornell Report"], p. 4.)

The day that the merger was effected, Thane's shares began to trade on the Nasdaq Over-the-Counter Bulletin Board[2] ("Nasdaq-OTCBB"). Thane's stock was never listed for trading on the Nasdaq-NMS, but, instead, continued to trade on the Nasdaq-OTCBB. (Class UF, No. 28.)

Between May 24, 2002 and June 11, 2002, Thane's stock price ranged between $8.50 and $7.00 per share. (Thane UF, No. 25.) On June 25, 2002 Thane announced its earnings results for the 2002 fiscal year. (*Id.*, No. 27) In its earnings announcement, Thane did not explain its failure to list on the Nasdaq-NMS. (*Id.*, No. 32.) On June 24, 2002, Thane's closing stock price was $6.00 per share, and on June 25, 2002, Thane's closing stock price was $5.25 per share. (*Id.*, No. 29.) Over the next month, from June 25, 2002 through July 24, 2002, the closing price of Thane's stock declined from $5.25 per share

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[1] Preston calculated a merger price of $6.99 using the merger ratio of 0.3049459 and data in Thane's 2002 Form 10-K, which valued the acquisition of Reliant at $24,700,000. Cornell calculated his merger price of $6.89 using the same merger ratio and Reliant's last quoted share price before the merger, $2.10.

[2] Prior to the merger, Reliant's securities traded on the Nasdaq-OTCBB. (Thane UF, No.2.)

to $2.25 per share, a decline of approximately 57%. (*Id.*, No. 30.)

On August 14, 2002, Thane announced its earnings results for the first quarter of the 2003 fiscal year. (*Id.*, No. 34.) The earnings were approximately 46% lower than the earnings for the same quarter in 2002. (*Id.*) From August 13, 2002 through August 16, 2002, the closing price of Thane's shares declined approximately 46% from $3.60 per share to $1.95 per share. (*Id.*, No. 35.)

On the basis of these facts, a class action complaint was filed on September 23, 2002 alleging that the Thane Defendants disseminated a materially misleading Proxy Statement/Prospectus in violation of Section 12(a)(2) of the Securities Act of 1933 (the "1933 Act"), 15 U.S.C. § 771(a)(2) ("Section 12(a)(2)"). In addition the complaint claims that the four individual defendants, Hay, DuBarry-Hay, McKeon and Taylor, in addition to having primary liability, are also jointly and severally liable for damages suffered by the Class as control persons within the meaning of the 1933 Act Section 15, 15 U.S.C. § 77o.

Approximately seventeen months after the complaint was filed, in February 2004, Thane completed a going-private transaction in which Thane's shareholders received $0.35 for each of their shares.

Discussion

All three motions seek summary judgment with respect to least some part of the Class' complaint. Summary judgment is appropriate only where the record, read in the light most favorable to the non-moving party, indicates that "there is no genuine issue as to any material fact and . . . the moving party is entitled to a judgment as a matter of law." Fed. R. Civ. P. 56(c); *see also Celotex Corp. v. Catrett,* 477 U.S. 317, 323-24 (1986). Material facts are those necessary to the proof or defense of a claim, and are determined by reference to substantive law. *Anderson v. Liberty Lobby, Inc,* 477 U.S. 242, 248 (1986). A fact issue is genuine "if the evidence is such that a reasonable jury could return a verdict for the nonmoving party." *Id.* at 248. In deciding a motion for summary judgment, "[t]he evidence of the nonmovant is to be believed, and all justifiable inferences are to be drawn in his favor." *Id.* at 255.

The burden initially is on the moving party to demonstrate an absence of a genuine issue of material fact. *Celotex,* 477 U.S. at 323. If, and only if, the moving party meets its burden, then the non-moving party must produce enough evidence to rebut the moving party's claim and create a genuine issue of material fact. *See id.* at 322-23. If the non-moving party meets this burden, then the motion will be denied. *Nissan Fire & Marine Ins. Co. v. Fritz Co., Inc.,* 210 F.3d 1099, 1103 (9th Cir. 2000).

1. The Class' Motion for Partial Summary Judgment and Thane's Motion for Summary Judgment

In its motion, the Class seeks summary judgment in its favor on all issues, except for damages, which it believes should be left for trial. Thane, on the other hand, seeks summary judgment on the issue of materiality and the affirmative defense of loss causation, which it believes should dispose of the entire case in its favor. The Court treats these motions together because of their overlapping issues.

The resolution of these motions appears to hinge on two major questions: (1) whether the market for Thane's stock was efficient; and (2) if the market for Thane's stock was efficient, at least to some degree, whether the alleged misrepresentation in the Proxy Statement/Prospectus affected Thane's share price such that the Class suffered damages.

First, the Court considers the question of whether or not Thane's stock was efficient. This inquiry appears to be of critical importance to this case, as it is one on which the parties have focused extensively. The Court agrees that this issue must be resolved before any other because, unless Thane's stock possessed some measure of efficiency,[3] its stock's

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[3] A perfectly efficient market is one in which every security's price equals its investment value at all times. (Ex. B to Supplemental Declaration of Michael Tu, W. Sharpe, G. Alexander & J. Bailey, *Investments* 105 (5th ed. 1995).) In a perfectly efficient market, a set of information is fully and immediately reflected in market prices. (*Id.*) An irrational market, or one in

(Continued on following page)

price did not reflect any company, industry or market information. In other words, if, as the Class contends, Thane's stock was not efficient, it would be impossible to measure, or factor out, the effect of any information on Thane's share price after the merger. Accordingly, any evidence purporting to connect the decline in Thane's share price to any market or company events, such as that offered by Thane via its expert Bradford Cornell, Ph.D. ("Cornell"), would be meaningless.

As explained more fully in the Court's tentative minute order re the parties' motions to exclude expert reports and testimony, the Court finds no issue of material fact that Thane's stock was efficient, at least to some degree. (*See* Tentative Minute Order re Parties' Motions to Exclude.) According to the relevant authorities, a perfectly inefficient market, in which stock prices are simply random, rarely, if ever exists. Based on Thane's stock price movement and the evidence contained in Cornell's report, which the Court found to be reliable and relevant (*see id.*), the Court finds that Thane's stock is not an exception. Rather, Thane's stock price reacted to company and

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which stock prices never bear any particular relationship to investment value, is the opposite of a perfectly efficient market. (*Id.* at 106.) Although financial experts conclude that U.S. securities markets are neither perfectly efficient nor irrational, most consider these markets to be much more efficient than irrational. (*Id.*)

market information in ways that demonstrated its efficiency, at least with regard to certain information.

Furthermore, even arguments advanced by the Class appear to require a finding that Thane's stock was at least partially efficient. According to the Class' expert, Candace L. Preston ("Preston"), a "nervous" market allowed Thane ten days after the merger to list its shares on the Nasdaq-NMS before beginning to react. The Court agrees with Thane that Preston's assertion that the market was watching Thane's stock implies at least some type of market efficiency. Furthermore, Preston testified that she picked the ten day period because, after ten days, "the price started to react," or drop. (Ex. D to Declaration of Michael C. Tu, Deposition of Candace L. Preston [hereinafter "Preston Depo."], at 201:12-14.) If the price reacted when the market began to conclude that Thane was not going to list on the Nasdaq-NMS, then the stock was at least somewhat efficient with regard to this information. It follows, therefore, that Thane's stock would also have been efficient with regard to other information and the evidence bears this out. The Court, accordingly, finds that there is no material issue of disputed fact that Thane's stock was at least somewhat efficient.

Because the Court has found Thane's stock to be efficient to some degree, it must consider the second question: whether the alleged misrepresentation in the Proxy Statement/Prospectus affected Thane's share price such that the Class suffered damages. This question lies at the very heart of this case,

underlying the element of materiality, the affirmative defense of loss causation and the calculation of damages, and is the primary focus of the parties' expert reports. The conclusions contained in these reports, naturally, differ.

According to Cornell, because Thane's stock traded above both sides' imputed merger prices for nineteen days after Thane began to trade on the Nasdaq-OTCBB, the Class suffered no damages as a result of the alleged misrepresentation. Furthermore, Cornell concludes that any decline in Thane's share price after the nineteen days was the result of market or industry factors, as opposed to the misrepresentation. In support of these conclusions, Cornell provides an event study, in which he conducted a detailed analysis of the effect of market and company events on Thane's share price and compared the movement of the stock price to that of the Nasdaq and an index of comparable companies.

The Class's expert, Preston, on the other hand reaches the opposite conclusion. In her report, she opines that the entire decline in Thane's share price during the twenty-one months following the merger can be attributed to the misrepresentation. As noted in the Court's tentative minute order re the parties' motions to exclude experts, the Court rejects this conclusion, finding that several other pieces of information influenced Thane's stock price during the time between the merger and the going-private transaction. (Tentative Minute Order re Parties' Motion to Exclude, p. 10.) In connection with this, the Court

also rejected Preston's damage calculations and "event analysis" because she failed to account for the effect of this other information on Thane's share price. (*Id.*, at 10-11.) Accordingly, the Court cannot consider these portions of Preston's report in deciding this question.

The Court, however, does consider that section of Preston's report in which she notes that Thane's stock began to decline ten days after the merger. According to evidence from both sides, in the period from May 24, 2002 through June 24, 2002, Thane's share price dropped 29%, while the share prices of comparable companies declined between 16% and 20% and those on the Nasdaq fell 12%. Although, this evidence indicates that Thane's share price fell, at least in part, as a result of market and industry factors, Thane provides no evidence that the additional 9% decline was also due to these factors. Accordingly, the Court finds that a trier of fact could determine that the misrepresentation contributed to the price decline.

In addition, the Court finds that the second half of Cornell's report, in which he determines the maximum theoretical economic harm to Thane's shareholders from listing on the Nasdaq-OTCBB versus the Nasdaq-NMS, could support a conclusion that, even though Thane's shares traded above the imputed merger price for nineteen days after the merger, the share price would have been $0.40 higher had the shares been listed on the Nasdaq-NMS.

On the basis of this evidence, the Court finds that a trier or fact could draw conflicting conclusions with regard to the issue of whether the alleged misrepresentation in the Proxy Statement/Prospectus affected Thane's share price such that the Class suffered damages. Accordingly, the Court finds that this question presents a genuine issue of material fact that must be determined at trial.

In addition, partly on the basis of this finding, the Court finds that several other genuine issues of material fact exist in this case.

Misrepresentation

First, the Court finds that, as Thane argues, the Class has failed to establish the absence of a genuine issue of material fact regarding to the existence of a misstatement. According to the Class, the Proxy Statement/Prospectus "explicitly represented . . . that Thane's stock would be listed for trading on the Nasdaq National Market." (Class Mot'n for SJ, p. 1.) A careful review of the Proxy Statement/Prospectus, however, reveals that this document does not say exactly that. Rather, the Proxy Statement/Prospectus states that Thane's common stock has "been approved for quotation and trading" (Ex. E to Declaration of Michael C. Tu, Proxy Statement/Prospectus [hereinafter "Prospectus"], p. 4 (emphasis supplied)) or is "*expected to meet* the initial listing requirements" of the Nasdaq-NMS. (Prospectus, pp. 3, 25 (emphasis supplied).) The Proxy Statement/Prospectus does not

explicitly promise that Thane's shares *will* list on the Nasdaq-NMS *immediately* after the merger went through. Nor does the section of the merger agreement cited by the Class make such a promise. In the merger agreement, it merely states that "Thane shall use *commercially reasonable efforts* to cause its outstanding Thane Common Stock immediately after the merger to be *approved for quotation*" on the Nasdaq-NMS. (Ex. E to Declaration of Michael C. Tu, Agreement and Plan of Merger, p. 49 (emphasis supplied).) The Proxy Statement/Prospectus and merger agreement could be read to imply an intent to list immediately, but that is not the only reading.

Thane contends that, because Thane did seek, and on April 9, 2002 received, approval from Nasdaq for quotation and trading on the Nasdaq-NMS, it satisfied the promises contained in the Proxy Statement/ Prospectus and the merger agreement. (Ex. 6 to Declaration of Joel C. Feffer in Support of Plaintiffs' Motions for Partial Summary Judgment and to Strike Defendants' Expert's Reports [hereinafter "Feffer Decl."], April 9, 2002 Nasdaq approval letter.) Furthermore, Thane argues that these statements were not misleading because Thane always intended to list Thane's shares on the Nasdaq-NMS. The reason it did not do so immediately was because it was advised by its investment bankers to wait until a second public offering. (Ex. F. to Supplemental Declaration of Michael C. Tu [hereinafter "Supp. Tu. Decl."], Deposition of William F. Hay, at 32:10-12.) This delayed listing never occurred, however, because Thane's

share price dropped below the $5.00 per share requirement of the Nasdaq-NMS and Thane determined that market conditions no longer favored a second offering. (Ex. M to Supp. Tu Decl., Thane's Form 10-Q for the Quarter Ended June 30, 2002, p. 15.)

In its briefs, the Class continues to contend that such statements did constitute misrepresentations and were misleading. Nonetheless, the Court finds that Thane has presented sufficient evidence to raise a genuine issue of material fact regarding the existence of a misstatement. As a result, the Court cannot grant summary judgment to either party.

Materiality

Both parties seek summary judgment on the issue of materiality. The Court, however, finds that a genuine issue of material fact exists on this issue.

According to Thane, had the alleged misrepresentations in the Proxy Statement/Prospectus been material, Thane's stock would have immediately declined. Thus, because Thane's stock traded above the imputed merger price for nineteen days after the merger, the alleged misrepresentations were not material to the market. The Class, on the other hand, offers a variety of less quantitatively-based evidence to show that the misrepresentations were material.

Section 12(a)(2) provides an express private right of action against anyone who "[o]ffers or sells" stock

"by means of a prospectus . . . which includes an untrue statement of *material* fact. . . ." 15 U.S.C. § 771(a)(2) (emphasis supplied). In *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438 (1976), the Supreme Court laid out the test for materiality. According to the Supreme Court, a fact is material if there is a "substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." *Id.* at 449. Both parties accept this as the basic standard for determining whether a misrepresentation is material.

Thane, however, asks this Court to also apply the Third Circuit's bright-line rule for materiality, according to which a misrepresentation or omission is immaterial as a matter of law if the market did not react immediately after disclosure of the misrepresented or omitted fact. *In re Burlington Coat Factory Sec. Litig.*, 114 F.3d 1410, 1425 (3d Cir. 1997). That position is foreclosed by the Ninth Circuit's rejection of this rule in *No. 84 Employer-Teamster Joint Council Pension Trust Fund v. America West Holding, Corp.*, 320 F.3d 920 (9th Cir. 2003).

In *America West,* the Ninth Circuit declined to adopt the Third Circuit's *per se* rule that the absence of an immediate market reaction to a corrective disclosure rendered the information immaterial as a matter of law. *Id.* at 934. Rather, the Ninth Circuit adopted the "reasonable investor" standard laid out in *TSC Industries* and *Basic v. Levinson,* 485 U.S. 224 (1988). *Id.* In *America West,* the Ninth Circuit

reasoned that because a market is not free from distortions that remain uncorrected for a period of time "adopting a bright-line rule assuming that the stock price will instantly react would fail to address the realities of the market." *Id.* Accordingly, the Ninth Circuit rejected the Third Circuit's bright-line test in favor of the "fact-specific inquiry" of *Basic. Id.*

Thane tries to sidestep the holding of this case because *America West* was decided in the context of a motion to dismiss and not on a motion for summary judgment. The Court disagrees, finding that the Ninth Circuit did not intend for courts to apply the "fact-specific inquiry" test only in the context of motions to dismiss, while applying the Third Circuit's bright line test on summary judgment. In fact, such a result would simply defy logic because "fact-specific inquiries," in most cases, are best conducted by the trier of fact or, at the very least, reserved for summary judgment, rather than attempted on motions to dismiss.

On this basis, the Court finds that it is bound by Ninth Circuit precedent to reject the bright-line rule Thane suggests should be applied to this case. This Court, instead, must rely on *TSC Industries'* fact-specific "reasonable shareholder" standard.

With this fact-specific standard in mind, the Court considers the evidence that both parties have presented on this issue. In support of a finding of materiality, the Class points the court to the numerous times the Proxy Statement/Prospectus referred to

listing on the Nasdaq-NMS and the inclusion in the merger agreement of a condition requiring listing on the Nasdaq-NMS. In addition, in her expert Report, Preston concludes, on several reliable bases, that these statements were material (Preston Report, ¶¶ 13-39) and indicates that the alleged misrepresentations did affect Thane's share price.

Thane, on the other hand, contends that the statements were not material because the market did not react negatively once the alleged misstatements became known. Instead, the market traded above the imputed price for nineteen days. Thane also argues that the fact that many of Thane's shareholders held onto their stock rather than selling it indicates that investors did not consider Thane's failure to list on the Nasdaq-NMS to be material. However, this view overlooks the fact that, even where there is an explicit announcement of the allegedly material fact, there may be a delay in market reaction. *America West,* 320 F.3d at 934-35 (delay from July 14, 1998 to September 3, 1998).

In light of the conflicting evidence from both sides, and the Court's determination above that an issue of material fact exists with regard to the question of whether the alleged misrepresentation in the Proxy Statement/Prospectus affected Thane's share price, the Court finds that a genuine issue of material fact exists on the issue of materiality. Accordingly, the Court must deny both motions for summary judgment on this ground, as well.

Loss Causation

The Court also finds that a genuine issue of material fact exists with regard to Thane's loss causation defense. This defense, which is found in Section 12(b)(2), states that defendants are entitled to summary judgment if they have shown that none of the alleged "amount recoverable" by plaintiffs was attributable to the purported misstatements or omissions in the prospectus.

Because this Court has found that a genuine issue of material fact exists with respect to the question of whether the alleged misrepresentation in the Proxy Statement/Prospectus affected Thane's share price such that the Class suffered damages, this Court finds that a genuine issue of material fact exists with respect to the affirmative defense of loss causation. For this reason, as well as those outlined above, the Court denies both motions for summary judgment.

Individuals' Liability

Next, with regard to the Section 12(a)(2) primary liability claim against the individual defendants, Hay, DuBarry-Hay, McKeon and Taylor (collectively "Individual Defendants"), the Court does find an absence of genuine issues of material fact and, on this basis, grants summary judgment in favor of the Individual Defendants on this claim.

Under Section 12(a)(2), individuals who offer or sell a security can be liable for misrepresentations. In interpreting this statute, the Supreme Court in *Pinter v. Dahl,* 486 U.S. 622 (1988), held that privity is unnecessary and that primary liability "extends [to a] person who successfully solicits the purchase, motivated at least in part by a desire to serve his own financial interests or those of the securities owner." *Id.* at 647. According to the Supreme Court, however, "soliciting" requires more than simply signing a prospectus. *Id.* Rather, courts have found that there must have been active solicitation that involved some sort of "direct contact" between the individual defendants and the plaintiff-purchasers. *In re Infonet Servs. Corp. Sec. Litig.,* 310 F. Supp. 2d 1080, 1101 (C.D. Cal. 2003).

According to the Class, because Thane did not employ an underwriter or broker to solicit Reliant's stockholders, Thane could only have solicited Reliant's shareholders through Thane's executive officers. In support of this conclusion, Thane points to the letter attached to the Proxy Statement/Prospectus signed by Kevin Harrington, Reliant's Chairman and Chief Executive Officer. (Ex. 6 to Feffer Decl. THNE 0001408-09.) The letter, however, does not represent that it was written on behalf of the Individual Defendants, or that they were in any way connected to it. Accordingly, this Court finds that the Class has not provided any evidence, beyond the fact that they drafted and signed the Proxy Statement/Prospectus, to show that the Individual Defendants actively

solicited Reliant's shareholders through any form of direct contact.[4] This lack of evidence requires the Court to find an absence of any genuine issue of material fact. Accordingly, the Court grants summary judgment in favor of the individual defendants on this claim.

Section 15 Claim

On the Class' Section 15 claims, the Court finds the existence of a genuine issue of material fact and, therefore, cannot grant summary judgment on this claim. In *Wool v. Tandem Computers, Inc.*, 818 F.2d 1433 (9th Cir. 1987), the Ninth Circuit held that to "state a claim that the individual defendants were 'controlling persons' . . . [plaintiff] must allege that: 1) the individual defendants had the *power* to control or influence the [defendant company], and 2) the individual defendants were *culpable participants* in [the defendant company's] alleged illegal activity." *Id.* at 1441. The Ninth Circuit held that this standard should be applied liberally. *Id.*

Under the first prong of *Wool*, the Class must show that the Individual Defendants had the power to control Thane. In support of this element, the

[4] The Court notes that Hay and McKeon played a role in negotiating the merger agreement with several principal Reliant stockholders who are, by definition, excluded from the Class (namely, the Harringtons). Because these stockholders are not part of the Class, the Court finds that any interaction that Hay and McKeon may have had with them is irrelevant to this claim.

Class first cites the position that each Individual Defendant holds in the company. Such assertions, however, without more, cannot support a finding of control under Section 15. *See Dennis v. General Imaging, Inc.*, 918 F.2d 496, 509-510 (5th Cir. 1990) ("While [defendant] was a director of [the corporation], this status alone will not automatically cause him to be deemed a Section 15 or 20 controlling person. He must be found to have influence over at least the direction of the firm."). *See also Wool*, 818 F.2d at 1441 ("ordinarily status or position of an alleged controlling person, by itself, is insufficient to presume or warrant a finding of power to control or influence").[5] In their Reply Brief, therefore, the Class cited several resolutions adopted by Thane's Board of Directors on December 5, 2001. (Class Reply, pp. 9-11.) In these resolutions, the "proper officers of the Corporation" were charged with numerous tasks connected to the merger, including preparing and filing the SEC forms, executing Nasdaq listing documents, and making any changes to any documents related to the merger. (*Id.*)

Nevertheless, the Court still finds that a genuine issue of material fact exists with regard to first prong of the *Wool* analysis. Although the foregoing evidence reveals that "proper officers of the Corporation" were

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[5] The Court agrees with Thane that the cases the Class cites, which state that an individual's status as a director or officer alone is sufficient to demonstrate control, are inapposite because they dealt with the standard on a motion to dismiss.

explicitly granted the power to influence or control Thane, the Class has failed to provide clear evidence that each individual defendant fell within this category. Accordingly, the first prong of the *Wool* test remains unsatisfied.

In addition, this Court finds that the second prong of *Wool,* which requires a showing that the individual defendants were culpable participants in the company's illegal activity, is not met because, as noted above, the Court has not found that any illegal activity has occurred.

Accordingly, the Court finds that it must deny summary judgment on the Class' Section 15 claim.

Class Damage Period

In addition, Thane seeks partial summary judgment cutting off the class period at June 4, 2002, the date the ten-day period during which Preston asserted the market was nervous and not reacting to the failure to list on the Nasdaq-NMS ended. In the alternative, Thane requests that the Court implement one of several other potential cut-off dates between June 4, 2002 and September 23, 2002, the date on which the complaint was filed in this action.

The Court declines to determine a specific cut-off date, but on this record there is no material dispute that the Class' damages ceased no later than August 16, 2002. The Court finds that this date is reasonable because on August 14, 2002 Thane released its

earnings for the quarter ended June 30, 2002, which were $0.06 lower than the same quarter in 2001, and, more importantly, announced the reason why Thane's shares had not and would not list on the Nasdaq-NMS: the company had intended to list in connection with a planned secondary public offering that had been cancelled when market conditions became unfavorable. After this announcement, Thane's share price dropped from $3.60 per share (August 13, 2002) to $1.95 per share (August 16, 2002), a decline of 46%.

Prior to this date, the Court finds that a portion of the decline in Thane's share price could reasonably be attributed to the misrepresentation because, from May 24, 2002 to September 23, 2002, Thane's stock price dropped twice as much as an index of its competitors, 78% as opposed to 39%. (Cornell Report, p. 8.) After the August 14, 2002 announcement, however, it was clear to the market that Thane would not be listed on the Nasdaq-NMS. Accordingly, the Court finds that once this information was impounded into the share price, which Cornell admits, and the Court agrees, could have taken until August 16, 2002, absolutely no further decline in Thane's stock could be attributed to the misrepresentation. Therefore, on this basis, the Court finds that there is no evidence

that would permit the class to collect damages beyond August 16, 2002.[6]

Affirmative Defenses

Finally, the Court addresses the Class' challenges to Thane's thirty-two affirmative defenses. The Court addresses each in the order set out in the Class' motion for summary judgment.

The Court agrees with the class that the first affirmative defense, failure to state a claim, is moot as a result of this Court's order entered June 25, 2003, denying Thane's motion to dismiss. Likewise, the Court finds that the fifth and twenty-fourth affirmative defenses are moot due to an order this Court issued, and which it has no reason to revisit, regarding intervenor-plaintiff Joseph J. Milkowski's motion for class certification.

Neither the third nor fourth affirmative defense is well taken because there are no state law claims and the complaint was filed within the statute of limitations. The Court also finds that the sixteenth affirmative defense, laches, is inappropriate because the complaint was filed only four months after the merger. Summary judgment is granted for the Class on these three affirmative defenses.

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[6] Whether the effects of the misrepresentation were in fact impounded in the stock price at an earlier date is a disputed issue of fact to be determined at trial.

On the other hand, the Court finds that it cannot grant summary judgment on the sixth, tenth, twentieth, twenty-third, thirty-first and thirty-second affirmative defenses because they involve issues, damages and loss causation, on which this Court has, respectively, not granted or explicitly denied summary judgment because genuine issues of material fact remain.

The Court agrees with the Class that the twelfth and twenty-sixth affirmative defenses, because they directly attack the issues of misrepresentation and materiality, elements of a claim under Section 12(a)(2), do not constitute affirmative defenses.

The Court, however, finds that a genuine issue of material fact exists with regard to the twenty-first affirmative defense, contribution, because liability, if any, has not yet been allocated among Thane and the individual defendants.

The Court does grant summary judgment for the Class on the twenty-second affirmative defense because it finds that there is no evidence that any class member directed, ordered, or approved Thane's conduct related to the misrepresentation. The Court does not agree with Thane that the decision of certain shareholders not to sell their shares indicates their implicit "approval" of Thane's actions in making the alleged misrepresentations.

In addition, the Court agrees with Thane that, in light of the safe harbor provision of Section 27A, which applies to Thane's stock via Section 13(a),

summary judgment cannot be granted on the fourteenth affirmative defense. Thane, however, does not challenge or present any evidence opposing the Class' request for summary judgment on its twenty-ninth affirmative defense. Accordingly, the Court grants summary judgment in the Class' favor on this defense.

Because the Court has already found that the Class has provided no evidence that the individual defendants solicited or sold stock to Thane's shareholders, the Court grants summary judgment in favor of Thane with regard to Thane's thirteenth, twenty-seventh, twenty-eighth and thirtieth affirmative defenses insofar as they relate to these defendants. The Court, however, denies summary judgment on these affirmative defenses with respect to Thane, the corporation.

With regard to the seventh, eighth, ninth, fifteenth, seventeenth, eighteenth and nineteenth affirmative defenses, the Court finds that, under *Pinter*, equitable defenses may apply to claims under Section 12(a)(2). *Pinter,* 486 U.S. 622. The Court, therefore, denies summary judgment on these affirmative defenses. The Court, however, grants summary judgment for the Class on the fifteenth (contributory negligence), eighteenth (set-off) and nineteenth (unclean hands) affirmative defenses because no evidence has been presented to support these defenses.

The Court denies summary judgment on the twenty-fifth affirmative defense because it finds that genuine issues of material fact remain with regard to (1) whether there was a misrepresentation and (2) whether the individual defendants knew or had reason to know about it.

2. DuBarry-Hay's Motion for Summary Judgment

DuBarry-Hay separately requests summary judgment in her favor on all issues. According to DuBarry Hay, she is entitled to summary judgment because there is no evidence that she knew or reasonably should have known of the alleged misstatements in the Proxy Statement/Prospectus regarding Thane's plans to list on the Nasdaq-NMS. In light of the above-ruling, this motion is moot with respect to the Section 12(a)(2) claim. With regard to the Section 15 claim, the Court disagrees, finding that a genuine issue of material fact remains. Accordingly, the Court denies the motion with respect to the Section 15 claim.

Section 15 states that a plaintiff may not prevail if "the controlling person had no knowledge of or reasonable ground to believe in the existence of the facts by reason of which the liability of the controlled person is alleged to exist." In her declaration, DuBarry-Hay asserts that she had no knowledge of Thane's decision to follow the investment bankers' advice to coordinate the planned Nasdaq-NMS listing with a secondary public offering contemplated to take

place later. (Declaration of Denise DuBarry-Hay [hereinafter "DuBarry-Hay Decl."], ¶ 3.) Furthermore, because her responsibilities at Thane focused solely on the creative aspects of the company and because she did not play a substantive role with respect to the merger, DuBarry-Hay claims she did not, nor had any reason to, know of Thane's plans with regard to the Nasdaq-NMS listing. (DuBarry-Hay Decl., ¶¶ 2-3.)

According to DuBarry-Hay, because there is no evidence that she had any knowledge of or failed to exercise reasonable care to discover that Thane allegedly misstated its intentions with regard to the Nasdaq-NMS listing, the Court should grant summary judgment in her favor.

The Class strongly contests DuBarry-Hay's claim that no genuine issues of material fact remain with regard to her presence in this case. In support of its opposition, the class cites DuBarry-Hay's deposition testimony in which she admits to having attended the meeting where the investment bankers advised Thane to list its shares on the Nasdaq-NMS upon a second public offering, which would take place a few months after the Thane-Reliant merger. (Ex. 2 to Feffer Decl., Deposition of Denise DuBarry-Hay, at 48:24-49:25.) In addition, the Class argues that DuBarry-Hay's position as a director and status as

the wife of Thane's Chief Executive Officer[7] raises questions regarding whether she knew or reasonably should have known about the alleged misstatements contained in the Proxy Statement/Prospectus.

The Court agrees with the Class that the evidence it has presented, primarily DuBarry-Hay's deposition testimony, creates a genuine issue of material fact on the question of whether DuBarry-Hay knew or should have known of the alleged misstatements. On this basis, her motion for summary judgment with regard to Section 15 is denied.

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[7] In *In re Health Mgmt., Inc. Sec. Litig.*, 970 F. Supp. 192 (E.D.N.Y. 1997), the court held in a securities case, in which a director signed a document containing alleged misstatements, that the director's marriage to the company's "President and Chairman of the Board of Directors" "evidence[d] her control status."

APPENDIX G

P-SEND

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA

CIVIL MINUTES – GENERAL

Case No. SACV 03-1031-JVS (SGLx) Dated: March 3, 2005

Title: HOWARD MILLER v.
THANE INTERNATIONAL, INC. et al.

PRESENT: HONORABLE JAMES V. SELNA, UNITED STATES DISTRICT JUDGE

Karla J. Tunis	Not Present
Courtroom Deputy	Court Reporter

ATTORNEYS PRESENT FOR PLAINTIFFS:	ATTORNEYS PRESENT FOR DEFENDANTS:
Not Present	Not Present

PROCEEDINGS: ORDER:

(In Chambers) (1) Granting Plaintiffs' Motion to Strike Defendants' Expert's Reports;
(2) Granting in Part Defendants' Motion to Exclude Expert Report and Testimony of Candace L. Preston

The Plaintiff Class ("Class") moves this Court for an order striking the expert reports of Bradford Cornell, Ph.D. ("Cornell") and preventing him from giving

expert testimony. Defendants Thane International, Inc., William F. Hay, Denise DuBarry-Hay, Kevin McKeon and Mark Taylor (collectively "Thane") also move this Court, pursuant to Federal Rule of Evidence ("FRE") 702, for an order excluding the expert opinion report and testimony of Candace L. Preston ("Preston"). The Court denies the Class' motion and grants, in part, and denies, in part, Thane's motion.

Discussion

FRE 702 governs the admission of expert testimony, a decision in which the Court has "broad latitude." *Elsayed Mukhtar v. California State Univ. Hayward,* 299 F.3d 1053, 1064 (9th Cir. 2002). Under FRE 702, in order for a court to admit expert testimony, the party offering such evidence must show it to be both reliable and relevant. *Kumho Tire Co. v. Carmichael,* 526 U.S. 137, 147 (1999); *Daubert v. Merrell Dow Pharms., Inc.,* 509 U.S. 579, 590-91 (1993). Specifically, FRE 702 permits expert testimony "if: (1) the testimony is based on sufficient facts or data; (2) the testimony is the product of reliable principles and methods; and (3) the witness has applied the principles and methods reliably to the facts of the case." Fed. R. Evid. 702.

When assessing the reliability of an expert's method or technique, a court should consider the four *Daubert* factors: (1) whether the theory or technique can be and has been tested; (2) whether the theory or technique has been subjected to peer review and

publication; (3) the known or potential rate of error and the existence and maintenance of standards controlling the technique's operation; and (4) whether the theory has gained general acceptance by the relevant scientific community. *Daubert,* 509 U.S. at 593-94.

If, after applying these factors, a court determines that the expert's methods are reliable, the court must then decide whether the testimony is relevant, i.e. whether it fits the facts of the case and will assist the trier of fact. *Id.* at 591-92. Once this decision is made, the court has fully performed its "gatekeeping" function and may admit an expert. Fed. R. Evid. 104(a).

1. The Class' Motion to Exclude Expert Opinion Report and Testimony

The Class asks this Court to strike Cornell's reports and prevent him from testifying. According to the Class, the reports: (1) are not based on accepted methodology; (2) are likely to confuse the jury at trial; and (3) are unreliable because they are inconsistent with Cornell's deposition testimony. As a result, the Class contends, the reports fail to meet the reliability and relevancy standards established by *Kumho Tire.*

Primarily the Class argues Cornell's reports are inadmissible because he refers to and uses techniques

applicable only to efficient markets[1] while failing, as he admitted at deposition, to actually determine that Thane's stock was efficient. (Deposition of Bradford Cornell, Ex. 5 to December 16, 2004 Declaration of Joel C. Feffer [hereinafter "Cornell Depo."], at 65:19-23.) According to the Class, two problems related to FRE 702 arise from this inconsistency. First, if the market for Thane's stock was not efficient, as the Class contends it was not,[2] Cornell's methodology was inappropriate and his conclusions are unreliable. Second, because the methods that Cornell used assume that Thane's stock was efficient, a jury will believe, in error, that Cornell concluded that Thane's stock was efficient.

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[1] A perfectly efficient market is one in which every security's price equals its investment value at all times. (Ex. B to Supplemental Declaration of Michael Tu, W. Sharpe, G. Alexander & J. Bailey, investments 105 (5th ed. 1995).) In a perfectly efficient market, a set of information is fully and immediately reflected in market prices. (*Id.*) An irrational market, or one in which stock prices never bear any particular relationship to investment value, is the opposite of a perfectly efficient market. (*Id.* at 106.) Although financial experts conclude that U.S. securities markets are neither perfectly efficient nor irrational, most consider these markets to be much more efficient than irrational. *Id.* at 106.)

[2] The Class contends that even Cornell admitted Thane's stock failed to meet the criteria for efficiency laid out in *Cammer v. Bloom*, 711 F. Supp. 1264 (D.N.J. 1989), when he acknowledged Thane's low trading volume, lack of analyst following and the existence of only one or two market makers. (Class Mot'n, p. 11; Cornell Report, p. 6; Cornell Depo., at 108:17-19; 109:17-20; 109:25-110:2.)

The Class asserts that the inconsistency in Cornell's reports render them unreliable because, unless Thane traded efficiently, the "event study" Cornell conducted to determine that the Class suffered little or no damages as a result of Thane's failure to list its stock on the Nasdaq National Market ("Nasdaq-NMS") is invalid.[3]

Event studies are important to damage analyses in securities cases because they filter out price effects that cannot be legally attributed to the defendant. *In re Imperial Credit Indus, Sec. Litig.*, 252 F. Supp. 2d

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[3] In addition to contesting the fundamental appropriateness of the event study, the Class also contends that Cornell conducted the event study incorrectly because he failed to perform a regression analysis. (Cornell Depo., at 77:8-12.) As support for this contention, the Class points to *In re World Access. Inc. Sec. Litig*, 310 F. Supp. 2d 1281 (N.D. Ga. 2004), which explains that an event study is a "statistical regression analysis that examines the effect of an event, such as an allegedly fraudulent statement or omission, on a dependent variable, such as a company's stock price." *Id.* at 1298 n.10.

Thane, on the other hand, disagrees with the Class' reading of *In re World Access* and contends that this case, and those like it, merely describe the particular method of event study used in those cases, not lay down their legal requirements. Thane asserts that regression analyses are not essential to event studies. As proof, Thane cites an article written by Haleblian & Finkelstein (and cited by the Class) that explicitly refers to event studies that are only adjusted for market factors and that do not involve regression analyses.

Upon review of this authority, the Court must agree with Thane that event studies do not require regression analyses. Therefore, the Court cannot strike Cornell's expert reports on this basis.

1005, 1014-15 (C.D. Cal. 2003). Such studies examine how a stock price responds to the release of company-specific information, while accounting for what is happening in the market overall and in an index of comparable companies.

In his event study, Cornell analyzed Thane's stock price movements in response to public news announcements from May 24, 2002, when the stock was first publicly traded, through September 23, 2002, when the Class filed the complaint, to determine whether those events were statistically significant. According to Cornell, while the market for Thane's stock was not perfectly efficient, his study showed that Thane's stock price moved in statistically significant ways upon the release of company-specific information and reflected both market and industry events. (Declaration of Bradford Cornell [hereinafter "Cornell Decl."], ¶¶ 4, 6, 8, 11; Cornell Report, p. 9.) For example, when Thane's August 14, 2002 earnings announcement disclosed a $0.06 drop per share, Thane's share price declined 46% over a three-day trading period. (Cornell Decl. 6, 11; Cornell Report, p. 9.) From these figures and through comparisons of Thane's performance to that of various indexes (Cornell Decl. ¶ 9; Cornell Report, p. 8), Cornell concluded that the decline in Thane's share price was not related to the failure to list on the Nasdaq-NMS, and the Class suffered no damages from the purported misrepresentation in the Proxy Statement/Prospectus. (Cornell Report, p. 9.)

According to the Class, an event study "assumes that the markets are informationally efficient, such that security prices reflect all publicly available information, and price changes reflect new information." Jerayr Haleblian & Sydney Finkelstein, *The Influence of Organization, Acquisition Experience on Acquisition Performance: A Behavioral Learning Perspective,* Admin. Sci. Q., March 1999, at 5. Because of this assumption, the Class contends that Cornell erred in conducting an event study without first determining that Thane's stock was efficient.

In response, Thane asserts that event studies do not require a prior determination that a market is efficient. (Cornell Decl., ¶ 13.) Rather, event studies themselves can determine the degree to which a market is efficient. (Ex. B to Supplemental Declaration of Michael Tu, W. Sharpe, G. Alexander & J. Bailey, *Investments* [hereinafter "Sharpe"] 97 (5th ed. 1995).) Accordingly, Thane contends Cornell's use of an event study without determining, in advance, Thane's stock to be efficient was appropriate. Furthermore, and perhaps more importantly, Thane argues that, contrary to the Class' assertions, Cornell's methods are appropriate and his reports are not misleading because he has been consistent in his opinion that Thane's stock, while not perfectly efficient, is efficient with respect to particular sets of information.

The Class rebuts this assertion by arguing that the concept that a stock can be efficient with respect to select information is counter-intuitive. Responding

to the Class, Thane states that this statement merely demonstrates the Class' fundamental misunderstanding of the efficient market theory.

According to Thane, the Class' belief that an efficient market is an "on/off switch," i.e. stocks that are not perfectly efficient cannot absorb any information over any length of time, is nonsensical. (Thane's Opp'n, p. 1.) Rather, Thane asserts, efficiency exists on a continuum. (Sharpe, at 105-06 (noting the three forms of market efficiency, weak, semi-strong, and strong).) Therefore, even though a stock may not be perfectly efficient, it can still be efficient, i.e. impound information into its price, with regard to certain information sets. (*Id.* at 106 ("A market is efficient with respect to a particular set of information. . . .").)

This concept, Thane contends, not only is a fundamental tenet of modern finance theory, but is one that simply makes sense for two reasons. First, because perfectly efficient and perfectly inefficient markets rarely, if ever, exist, market efficiency naturally must be measured in degrees, rather than in the absolute. Second, some types of information are clearly easier to observe and process than others. Therefore, certain information will be absorbed more rapidly than others. For example, were Thane to decide to change its product mix, the new information might not get immediately impounded into its price because the stock was thinly traded and lacked analyst coverage. On the other hand, knowledge of where Thane's stock was traded was immediately obvious. Accordingly, Thane argues, this latter information

must have been incorporated rapidly into Thane's stock price.

Based on these concepts and the fact that Cornell found that Thane's stock demonstrated objectively measurable efficiency with respect to particular sets of information,[4] Thane contends that the event study that Cornell conducted was appropriate and not misleading.

The Court agrees with Thane. The authorities to which Thane cites clearly show that market efficiency exists on a continuum and that a stock can be efficient with regard to particular information sets. Because Cornell has indicated in both his Report and his Declaration that, although it was not perfectly efficient, Thane's stock did respond to certain information,

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[4] The Class argues that the share price movements that Cornell observed are unreliable because Thane's stock also moved appreciably without any corresponding release of information. In response, Thane asserts that such movement is not rare and that even highly efficient markets exhibit some statistically significant price movements in the absence of publicly disclosed information. (Ex. E to Supplemental Declaration of Michael Tu, R. Roll, R^2, J. of Fin. 541, 559 (July 1998).) Furthermore, these types of statistically significant movement become even more common when stocks trade at low dollar values because at those levels percentage changes are magnified.

Based on the authority Thane cites and the simple mathematics, i.e. a change of a few cents appears more significant for a stock priced at two dollars than for a stock priced at ten, the Court agrees with Thane and finds that these changes do not render the results of Cornell's event study unreliable.

indicating some level of efficiency, the Court finds that his report is not misleading and does not threaten to confuse the jury. In light of this finding, and because the Court finds that an expert need not make a determination of efficiency prior to conducting an event study (because such studies are designed to show where on the continuum a particular stock lies), the Court further finds that Cornell's use of an event study, even absent regression analysis and in spite of his opinion that the efficiency of Thane's stock was a "gray area" (Cornell Depo., p. 66), was appropriate in this context.

Besides its main contention regarding the efficiency of Thane's stock, the Class raises several other issues in its motion. First, the Class asserts that Cornell's statements that the market was fully aware of where Thane's stock was listed are misleading. In the reports, Thane contends that the term "market" appears to include all Thane shareholders. Cornell, however, testified in his deposition that, by the term "market," he means only those people buying and selling the stock. (Cornell Depo., at 64:4-5). The Class asserts that this inconsistency could mislead the trier of fact.

The Court disagrees. In the context of the market efficiency arguments in which these statements were made, they cannot be misleading because a belief that Cornell intended the term "market" in these statements to mean "every single shareholder" is absurd. If every single shareholder, regardless of whether they were actually buying or selling shares and

thereby affecting share price, needed to be aware of a certain information set in order for the market to be efficient with regard to this information, i.e. for it to be reflected in the share price, markets would never be efficient with regard to anything. Clearly this is not the case. In reality, even in highly efficient markets, e.g. Microsoft, every single shareholder need not be aware of all of the information affecting the stock in order for financial analysts to conclude that the information is completely impounded into the share price.

Next, the Class asserts that, in violation of Federal Rule of Civil Procedure ("FRCP") 26, neither of Cornell's reports cite with any degree of specificity what evidence he relied upon in reaching his conclusions. The Court disagrees. The Court finds that Cornell has clearly explained the data upon which he relied, the methods he used, and the manner in which he reached his conclusions.

Finally, the Class contends that the reports were "ghost-written" by others, including attorneys and assistants. With regard to Cornell's interactions with his attorneys, it is well-established that experts may discuss aspects of their reports with counsel in the course of their preparation. Advisory Committee Notes to the 1993 Amendments to Fed. R. Civ. P. 26(a)(2). Under this rule, the Court finds no evidence that Cornell improperly interacted with Thane's attorneys. Next, on the issue of assistants, federal courts have held that experts may use assistants to help them prepare expert reports so long as the

experts sign the report and attest to the accuracy of their contents. *United States v. Dallide,* 227 F.3d 385, 392 n.6 (6th Cir. 2000). Here, Cornell has testified that he reviewed all of the event study calculations performed by his assistants and that he drew his own conclusions about what the data showed. (Cornell Depo., at 50:17-23.) Accordingly, the Court finds Cornell's use of assistants here to be appropriate.

Based on the foregoing, the Court finds that Cornell has reliably applied accepted methods and techniques to the facts of this case in satisfaction of *Daubert, Kuntho Tire* and FRE 702. Furthermore, the Court finds that Cornell's reports and testimony will assist the trier of fact and are therefore relevant. The Court denies the Class' motion. Fed. R. Evid. 702.

2. Thane's Motion to Exclude Expert Opinion Report and Testimony

Thane seeks to exclude Preston's expert report and prevent her from testifying at trial because she used unscientific and unreliable methods to arrive at conclusions that are self-contradicting. For these reasons, Thane contends, Preston's report fails to satisfy the requirements of FRE 702 and is inadmissible under *Daubert* and *Kumho Tire.*

First, Thane takes issue with Preston's opinion that, because Thane's stock did not trade efficiently, the market could not react to the alleged misrepresentation in the Proxy Statement/Prospectus, even though it was material. According to Thane such a

situation defies modem finance theory, which holds that a market that absorbs information will respond via stock price changes. (E. Fama, *Efficient Capital Markets: II,* J. Fin. 1575 (Dec. 1991).) In other words, it is simply impossible for information to be absorbed by, or material to, the market without clearly affecting the stock price. (G. Dent, *Dual Class Capitalization: A Reply to Professor Seligman,* 54 Geo. Wash. L. Rev. 725, 741-41.) On this basis, Thane contends, it is fundamentally inconsistent for Preston to opine that, even though there was no quantifiable effect on Thane's share price, the market was nervous about, or paying attention to, the alleged misrepresentation. According to Thane, this inconsistency renders Preston's report unreliable.

In addition, Thane contends that Preston contradicts herself by concluding that the alleged misrepresentation was material while claiming to be unable to discern a point where the market impounded that information into Thane's stock price. According to Thane, it would be impossible to determine that information was material, or had some effect, if one could not find some point at which share prices reflected this information.

Finally, Thane disputes Preston's assertion that she could opine that the purported misrepresentation was material based on the contents of the Proxy Statement/Prospectus simply because of her professional expertise. (Deposition of Candace L. Preston, Ex. D. to Declaration of Michael C. Tu [hereinafter "Preston Depo."], at 86:17-87:8.) In Thane's opinion,

first, an expert's expertise, without more, is not an appropriate method to use to draw conclusions, and, second, reading a prospectus is not an exercise that requires an expert. Rather, a court or a trier of fact can competently read a prospectus and draw conclusions therefrom. *See In re Stratosphere Corp. Secs. Litig.*, 66 F. Supp. 2d 1182, 1188 (D. Nev. 1999) (stating that it "does not take any special competence, for example, to read pertinent public documents (e.g. prospectuses, press releases, and recorded statements) to determine whether certain risks were conveyed to the public").

Although not directly addressed by the Class in its opposition to Thane's motion, the Court nonetheless disagrees with Thane that, on the above bases, Preston's report should be excluded. First, the Court finds that Preston's report does conclude that, after ten days, the alleged misrepresentation, even if not completely absorbed, was reflected to some degree in Thane's share price. (Preston Report, ¶¶ 49-51.) According to Preston, beginning on June 4, 2002, Thane's share price began to decline and underperform certain competitor companies and general market indexes. (*Id.* at ¶ 49, 51.) Because the first evidence of any company- or market-related events that could have completely accounted for the decline was Thane's earnings release on June 25, 2002, the Court finds that Preston's opinion that the decline

was due, at least in part, to the purported misrepresentation is reasonable and reliable.[5]

The Court, therefore, will allow Preston to express the opinions in paragraph 49 through the end of the second sentence in paragraph 51 of Preston's report that the purported misrepresentation was material because the stock price declined after June 4, 2002. The Court, however, specifically prohibits the Class from using this portion of the expert report as evidence of damages because Preston did not even attempt to factor out the effect of other events that could have accounted for a portion of the decline.

The Court also finds that the first portion of Preston's report, in which she deals with issues of materiality (*Id.* ¶¶ 13-25) and whether investors were misled (*Id.* at ¶¶ 26-39) are reliable and relevant. The Court disagrees with Thane's assertion that Preston's review of the Proxy Statement/Prospectus could have just as easily been done by this Court. Here, Preston did not merely review the Proxy Statement/Prospectus to determine exactly what information it contained. Rather, Preston used her experience as a financial analyst to opine on the reason why Thane included certain statements in the Proxy Statement/Prospectus

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[5] In reaching this conclusion, the Court did not consider the issue of whether or not damages may be available for the period of the post-June 4, 2002 decline during which the shares traded above the imputed merger price. The Court simply determined whether Preston's report contained any reasonable conclusions that the alleged misrepresentation affected Thane's share price.

and the importance of this document to investors, especially because the merger created a new company without a track record. Preston also drew upon her experience as a financial analyst to render reliable and relevant opinions on the benefits of listing on the Nasdaq-NMS, as opposed to the Nasdaq-OTCBB.

The Court, therefore, finds Preston's opinions on materiality and whether investors were misled (*Id.* at ¶¶ 13-39) to be reliable, as based upon her professional experience, and relevant because they will assist the trier of fact. Accordingly, the Court will allow Preston to express the opinions in paragraphs 13 through 39 of Preston's report that the alleged misrepresentation was material and misled investors. The Court further permits Preston to use this portion of her report to show that the Class was damaged to some degree by the purported misrepresentation. The Court, however, notes that these opinions are not a substitute for damage computations that factor out other events that may have contributed to the decline in Thane's share price.

Next, Thane contends that Preston's attribution of the entire loss in value of Thane's stock price to Thane's failure to list on the Nasdaq-NMS is based on wholly unreliable methods. According to Thane, Preston errs in finding that, because Thane's stock was not perfectly efficient, all of the market events, aside from the alleged misrepresentation, that occurred during the twenty-one months after the merger are irrelevant. Thane further contends that because Preston's fundamental premise was flawed,

her conclusion that the entire decline in Thane's share price can be attributed to the purported misrepresentation is invalid.

As noted above, the Court agrees with Thane that a stock need not be perfectly efficient in order for its price to reflect company- or market-related information. Based on the evidence contained within Cornell's report, the Court finds that during the twenty-one months after the merger Thane's stock price was affected by a number of things, including general market and industry trends and Thane's earning reports.

Furthermore, based on Cornell's report and testimony and the authorities upon which he relied, the Court finds that Preston could and should have factored out, at least to some degree, these effects in order to determine the effect of the alleged misrepresentation on Thane's share price. The Court, therefore, finds Preston's failure to even attempt to control for or quantify such factors unacceptable under *Imperial Credit*. *See* 252 F. Supp. 2d at 1016 (holding that an expert's opinion must take into account "market events for which Defendants cannot be held responsible" and must "eliminate that portion of the price decline of [the] stock which is unrelated to the alleged wrong."). The failure to factor out the effect of known events is not merely one of degree to be brought out on cross-examination, but represents a fundamental flaw which invalidates Preston's damage calculation. Preston's criticism's of Thane's efficiency may explain her inability to determine the

point at which the market impounded Thane's failure to list on the Nasdaq-NMS; it is not the basis for ignoring events such as the drop in Thane's share value following its negative August earnings report.

The Class, however, vigorously opposes this conclusion on the grounds that at least one federal court has accepted the type of "event analysis" Preston conducted here. In *RMED International, Inc. v. Sloan's Supermarkets, Inc.*, 2000 WL 310352 (S.D.N.Y. Mar. 24, 2000), *aff'd*, 2000 WL 420548 (S.D.N.Y. April 18, 2000), the Court admitted a non-statistical event analysis, allegedly similar to the one in this case, conducted by Preston. There, the court accepted Preston's event analysis, even though she had not used any formal statistical methods, because the required price history for the stock did not exist. *Id.* at *7. Because the situation here is analogous, the Class argues that this Court should also find the method Preston employed in *Sloan's* to be acceptable. The Court, however, need not opine on the acceptability of this method because Preston did not conduct the same type of analysis here.

In *Sloan's*, the court specifically notes that, in her event analysis, Preston "account[ed] for general economic, market and industry influences" and "analyze[d] company-specific events which might have been the cause of the price movement of Sloan's stock." *Id.* at *4. The court even distinguishes Preston's event analysis from that performed in *In re Oracle Securities Litigation*, 829 F. Supp. 1176 (N.D. Cal. 1993), where the expert "failed to employ any

methodology to eliminate information . . . other than the alleged fraud that might have influenced the stock price," on this ground. *Id.* at 1181. According to the court, Preston's method differed from that used in *Oracle* because she "conducted a microanalysis of each company-specific event which could have influenced Sloan's stock price, methodically charting those events on a daily basis." *Sloan's,* 2000 WL 310352, at *6.

Because this Court finds that Preston did not employ any of the methods that she used in *Sloan's* to control for outside effects on share price, the Court is not persuaded by this case to accept that portion of Preston's report related to damages. Accordingly, the Court remains firm in its decision that Preston's conclusions on the issue of damages and her damage calculations are unreliable because they are not based on an accepted methodology. The Court, therefore, grants Thane's motion to exclude Preston's expert report insofar as it relates to the issue of damages or damage calculations. Fed. R. Evid. 702. The Court also bars her from providing testimony on either of these issues, as well.

Next, Thane attacks Preston's "economic suicide" theory, which Preston offers to explain why Thane's shareholders did not sell their shares as soon as the purported misrepresentation was revealed. In this theory, Preston asserts that, even though shareholders thought the alleged misrepresentation was material, they nevertheless decided not to sell their shares at a profit, because they collectively knew that "it

would have been virtually impossible" to sell "more than a few hundred shares at any given time" without depressing the stock's price. (Preston Report, at ¶ 55.) The Court finds this to be little more than unsubstantiated speculation.

The Class notes that the statement in the Proxy Statement/Prospectus states, "Sales of a substantial number of shares of Thane common stock in the public market after this offering could depress the market price of Thane common stock." (Ex. 18 to Opposing Declaration of Joel C. Feffer.) While undoubtedly true, this does not explain why an investor would hold if he believed that continued retention of the stock was to his detriment. And it hardly explains why a savvy investor who first perceived the effect of the misrepresentation would not attempt to be the first out of the market, presumably beating or minimizing the effects of any slide.

Finally, Thane takes issue with the portion of Preston's report dealing with bid-ask spread. According to Thane, when comparing the bid-ask spread that Thane experienced after the merger with what Reliant shareholders experienced before the merger, Preston failed to include the days in which Reliant had spreads well in excess of those experienced by Thane. At her deposition, Preston could not offer an explanation for her failure to include the larger Reliant spreads beyond, "This is about Thane." (Preston Depo., at 172:21-22.)

The Court finds this unconvincing.

In addition, in her comparison between Thane's spreads and those of a weighted average of the entire Nasdaq-NMS, Preston used Thane's "outside" spreads[6] but the Nasdaq-NMS' "inside" spreads.[7] Thane contends that this comparison is misleading because inside and outside spreads are not comparable. Furthermore, Thane asserts that the comparison would have been inappropriate even had Preston used all "inside" spreads. Because the weighted Nasdaq-NMS index contains very large companies, such as Microsoft, that, because of their large public floats and significant analyst following, have very narrow spreads, it is inherently not comparable to the spreads of companies like Thane that have small public floats and little to no analyst following. The Court agrees on both points.

Accordingly, the Court excludes Preston's comparisons of spreads, paragraphs 43 through 45 of her report, as misleading, and therefore, unreliable under FRE 702, Fed. R. Evid. 702.

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[6] An "outside" spread is a single market maker's bid and ask prices.

[7] Under the "best execution" rules governing the Nasdaq, a broker must sell at the highest bid price and buy at the lowest ask price from all dealers making a market. This is known as the "inside spread."

APPENDIX H

15 U.S.C. § 77*l*. Civil liabilities arising in connection with prospectuses and communications

Sec. 12.

(a) In general

Any person who –

(1) offers or sells a security in violation of section 77e of this title, or

(2) offers or sells a security (whether or not exempted by the provisions of section 77c of this title, other than paragraphs (2) and (14) of subsection (a) of said section), by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission,

shall be liable, subject to subsection (b) of this section, to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the

tender of such security, or for damages if he no longer owns the security.

(b) Loss causation

In an action described in subsection (a)(2) of this section, if the person who offered or sold such security proves that any portion or all of the amount recoverable under subsection (a)(2) of this section represents other than the depreciation in value of the subject security resulting from such part of the prospectus or oral communication, with respect to which the liability of that person is asserted, not being true or omitting to state a material fact required to be stated therein or necessary to make the statement not misleading, then such portion or amount, as the case may be, shall not be recoverable.

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15 U.S.C. § 77*o*. Liability of controlling persons

Sec. 15.

Every person who, by or through stock ownership, agency, or otherwise, or who, pursuant to or in connection with an agreement or understanding with one or more other persons by or through stock ownership, agency, or otherwise, controls any person liable under sections 77k or 77*l* of this title, shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable, unless the controlling person had no knowledge of or reasonable ground to believe in the existence of the facts by reason of which

the liability of the controlled person is alleged to exist.

APPENDIX I

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Counsel for Plaintiffs and the Class

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA
SOUTHERN DIVISION

HOWARD MILLER, on behalf of himself and all others similarly situated; Plaintiff, v. THANE INTERNATIONAL, INC., et al., Defendants.	Civil Action No. 03-CV-1031 JVS Hon. James V. Selna TRIAL DATE: April 12, 2005 TIME: 8:30 A.M. PLACE: Courtroom 10-C

TRIAL DECLARATION OF PLAINTIFFS' EXPERT CANDACE L. PRESTON

DECLARATION

I, Candace L. Preston, hereby declare and state as follows:

1. I have personal knowledge of the matters set forth herein, and can and would testify competently thereto.

2. I am a founding member of Financial Markets Analysis, LLC ("FMA"). FMA is a securities analysis film with offices in Princeton, New Jersey and San Diego, California. FMA provides financial analysis and consulting services to its clients. FMA has frequently been called upon to prepare reports and to testify as securities valuation experts in class

actions under Federal and state securities laws. Such testimony has included matters relating to: (i) market efficiency; (ii) the materiality of information; (iii) loss and damage causation; (iv) the valuation of publicly traded securities based upon the hypothetical absence of alleged misstatements and the disclosure of alleged omissions and misrepresentations; and (v) damage calculations.

3. I am a graduate of Eastern Michigan University, from which I received a Bachelor of Arts, and the Wharton School of Finance, University of Pennsylvania, from which I received an M.B.A. Before joining FMA, I was a managing director of BNY Capital Markets, Inc. ("BNY"), the wholly-owned investment banking subsidiary of the Bank of New York. At BNY, I was in charge of valuations including those prepared in conjunction with mergers and acquisitions, private placements, fairness opinions, appraisals, and litigation.

4. Prior to joining BNY, I was a founding partner of Triumph Partners, LLC ("Triumph"), a valuation and financial consulting firm. Before founding Triumph, I was an executive vice-president of Princeton Venture Research, Inc. ("PVR").

5. I have been retained in hundreds of litigation assignments. I have testified in Federal and state courts and in arbitration proceedings. Courts have relied upon my analyses and, testimony in determining value and damages. I was the expert witness for the United States Securities and Exchange

Commission (the "SEC") in its prosecution of Eddie Antar and his family, the founders of Crazy Eddie, Inc. While I was in charge of valuations and litigation at PVR, we were chosen by Judge Milton Pollack to establish damages in the shareholder litigation cases involving Michael Milken and Drexel Burnham Lambert. In addition, I have worked for the Securities Investors Protection Corporation, Federal Deposit Insurance Corporation, and numerous other public and private clients.

6. I have been a guest lecturer on finance and valuations at the University of Chicago and at the Wharton School of Pennsylvania. I have been a speaker at the American Bar Association's Annual Meeting and at the New Jersey Bar Association, in each instance discussing securities class action damages.

7. I have achieved the professional designation of Chartered Financial Analyst (CFA) and am a member in good standing of the CFA Institute (formerly the Association for Investment Management and Research). The CFA program is a globally recognized standard for measuring the competence and integrity of financial analysts. Its curriculum develops and reinforces a fundamental knowledge of investment principles. The curriculum includes Ethical and Professional Standards, Quantitative Methods, Economics, Financial Statement Analysis, Corporate Finance, Analysis of Debt Investments, Analysis of Equity Investments, Analysis of Derivatives, Analysis of Alternative Investments, Portfolio

Management, and Performance Measurement and Attribution. Three levels of examination measure a candidate's ability to apply these principles at a professional level. I also participate in the CFA Institute's continuing education program.

8. My opinions and testimony have been accepted by numerous Federal District Courts, including: (1) *In Re Real Estate Associates Limited Partnership Litigation*, United States District Court, Central District of California; (2) *In Re Frontier Insurance Group, Inc.*, United States District Court, Eastern District of New York; (3) *In Re: Securities and Exchange Commission v. Sam M. Antar, Allen Antar, and Benjamin Kuszer*, United States District Court, District of New Jersey; (4) *In Re: RMED International, Inc. v. Sloan's Supermarkets, Inc. and John A. Catsimatidis*, United States District Court, Southern District of New York; (5) *In Re: Crazy Eddie, Inc.*, United States District Court, Eastern District of New York; and (6) *In Re: Digital Systems International*, United States District Court, Western District of Washington at Seattle.

9. In addition, I was determined at trial or binding arbitration to be qualified as an expert in: (1) *In Re Church's Fried Chicken, Inc.*, United States District Court, Western District of Texas, San Antonio Division; (2) *Cede & Co. and Cinerama, Inc. v. Technicolor, Inc., Delaware Chancery Court*; and (3) *In Re: Chevron U.S. Inc. f/k/a Gulf Oil Corp.*, United States District Court, Southern District of New York. A list of matters in which I have testified at deposition

and/or trial within the past four years is attached to the report submitted in connection with this action as Exhibit A. *See* Exhibit A hereto.

10. I was retained by plaintiffs' counsel as an expert witness in connection with plaintiffs' case-in-chief to render an opinion on the materiality of the misstatements and omissions alleged in this action regarding the listing of Thane International, Inc. ("Thane") common stock on the NASDAQ National Market following the merger of Reliant Interactive Media Corp. ("Reliant") with and into a wholly-owned subsidiary of Thane (the "Merger"). My opinions in this declaration are in accordance with this Court's March 3, 2005 opinion. I also expect to be called as a rebuttal witness in connection with defendants' affirmative loss causation defense.

11. Specifically, in this declaration I am opining on the materiality of defendants' alleged misstatements regarding the listing of Thane's common stock for trading on the NASDAQ National Market following the Merger. In connection therewith, on May 20, 2004, I submitted an expert report which was subsequently updated on December 6, 2004. *See* Exhibit A: Trial Exhibit 53. Defendants' counsel deposed me on November 15, 2004.

12. It is my opinion that defendants' alleged misstatements, regarding the listing of Thane stock on the NASDAQ National Market, were material to investors.

13. My opinions are based upon my professional knowledge and experience as well as my review of certain documents and data including:

a. the Class Action Complaint (the "Complaint");

b. the Order Denying Defendants' Motion to Dismiss Pursuant to Federal Rule of Civil Procedure 12(b)(6);

c. the Order Granting Joseph Milkowski's Motion for Class Certification;

d. the Court's March 3, 2005 Order and Opinions Regarding Summary Judgment and the Admissibility of Expert Opinion;

e. the deposition transcripts of Kevin Harrington, William F. Hay, Kevin McKeon, Sami Mnaymneh, Mark Taylor, Howard Miller, and Joseph Milkowski;

f. filings with the Securities and Exchange Commission such as Form 10-Ks, Form 10-Qs, and Form 8-Ks for Reliant, Thane and other companies in the direct marketing industry;

g. the Registration Statements and Amendments thereto filed in conjunction with the Merger and the Reliant Proxy Statement/ Prospectus dated April 23, 2002 (respectively, the "Registration Statement" and the "Prospectus" or "S-4"; collectively, the "Offering Materials");

h. press releases issued before and after the Merger by Reliant and Thane and other companies that operated in the direct marketing industry;

i. news articles published in the general and financial press before and after the Merger about Reliant, Thane, and other direct marketing companies;

j. reports published by security analysts about Reliant and other direct marketing companies before and after the Merger;

k. daily and intra-day reported price and volume data for the common stock of Reliant, Thane, and other direct marketing companies before and after the Merger;

l. daily reported price data for the NASDAQ Composite Index, the Dow Jones Internet Commerce Index, Goldman Sachs Technology Index: Internet and the U.S. E-Commerce Services Index before and after the Merger;

m. statistical data for the OTCBB and the NASDAQ National Market; and

n. documents produced in discovery in this litigation.

The Materiality of the NASDAQ National Market Listing

14. It is my opinion that defendants' alleged misstatements led the market to believe that Thane's shares would be listed on the NASDAQ National

Market immediately following the beginning of trading after the Merger provided that the price prior to NASDAQ National Market listing was above $5.00. As a result of the alleged misstatements contained in the Offering Materials, defendants were able to create the false impression that following the Merger, Thane shareholders would enjoy the increased benefits of trading on the NASDAQ National Market. It is also my opinion that these alleged misstatements and omissions were material to investors in Reliant considering whether or not to continue to hold their Reliant shares and exchange them for Thane shares or to sell them in the open market before the Merger.

15. The most compelling evidence of materiality of the NASDAQ National Market listing is the emphasis placed on the listing in the Offering Materials. The Prospectus touts the fact that Thane shares would trade on the NASDAQ National Market following the Merger. For example, the letter to stockholders, which appears at the beginning of the S-4 filed by Thane on January 3, 2002, states:

> It is a condition to the merger that the shares of Thane common stock to be received by stockholders of Reliant in connection with the merger be quoted or listed on the NASDAQ national market or a national securities exchange.

See Letter to Stockholders in the S-4 dated January 2, 2002 annexed hereto as Exhibit B: Trial Exhibit 100 at THNE 00368.

16. As an analyst who has reviewed hundreds, if not thousands of registration statements, it is my experience that companies do not include as "a condition to the merger" anything that is not material. Furthermore, the S-4 filed on January 3, 2002 included at least six other references to the listing of Thane's stock on the NASDAQ National Market. It is my opinion that highlighting this information through repetition demonstrates its materiality.

17. In the third amendment to the S-4, Thane again mentioned its intent to list on the NASDAQ National Market numerous times. However, instead of noting that such a listing was a condition of the Merger, the letter to stockholders led the investment community to believe that condition had been satisfied when it stated:

> The shares of Thane common stock to be received by stockholders of Reliant in connection with the merger have been approved for quotation and trading on the NASDAQ National Market upon completion of the merger, subject to Thane's compliance with the minimum bid price requirements of $5.00 per share.

See Letter to Stockholders in the S-4 dated April 23, 2002 and represented as being mailed to stockholders

on or about April 29, 2002: Trial Exhibit 2 at THNE 001140.[1]

18. Additionally, the S-4 highlights the listing on the NASDAQ National Market as one of the reasons for the Merger. Under the heading "Reliant's Reasons for the Merger" the S-4 stated:

> The Reliant board of directors concluded that the merger was in the best interests of Reliant and its stockholders. In reaching its decision, the board of directors considered, among other things, its belief that:
>
> > The combined company is expected to meet the initial listing requirements of the NASDAQ National Market, which would provide the Reliant stockholders. with greater liquidity than they have with Reliant common stock trading on the over-the-counter market.

Amendment No. 3 to the S-4, at 3: Trial Exhibit 2 at THNE001146.

19. The inclusion of the expectation that Thane stock would trade on the NASDAQ National Market is clear evidence of its materiality. It is my opinion, supported by over 25 years of experience as an analyst, that companies do not include immaterial

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[1] Trial Exhibit 2 is annexed to the Trial Declaration of Joseph J. Milkowski as Exhibit B.

information when explaining to shareholders the reasons for a merger.

20. A stock's trading in a national securities market such as the NASDAQ National Market is so important that the SEC requires disclosure of same on the outside front cover of every prospectus, including those filed as part of a registration statement on Form S-4, such as Thane's registration statement here. *See* 17 C.F.R. § 239.25, Part I.A. Item 1 and Regulation S-K, Item 581(b)(4), 17 C.F.R. § 229.501(b)(4).

21. Defendants must have believed that listing Thane's stock on the NASDAQ National Market was one of the "key aspects of the offering" of Thane stock to Reliant's stockholders because when complying with SEC rules (*see* SEC Regulation S-K, item 503(a), Instruction to "Prospectus Summary," 17 C.F.R. § 229.503(a)) they represented, not once, but twice, that Thane's stock would be so listed.

22. In addition, the expectation that Thane stock trading on the NASDAQ National Market would provide Reliant shareholders with greater liquidity than they had at that time with Reliant common stock trading on the over-the-counter market was material to investors because greater liquidity is generally accompanied by greater investor returns.

23. Liquidity is defined as "the ability of individuals to trade quickly at prices that are reasonable

in light of underlying demand/supply conditions."[2] In general, greater liquidity includes a reduction in the "spreads" at which stocks trade.[3] "To most investors, the spread represents a built-in loss at the time of investment."[4] To the extent that the spreads are reduced, the investor pays less and will realize higher returns than if the spread were larger. The concept of liquidity also conveys the ability of the market to absorb large volume without a change in price.

24. Liquidity refers to a market's ability to provide immediate execution for an incoming market order (often called "immediacy") and the ability to execute small market orders without large changes in the market price (often called "market depth" or "resiliency").[5]

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[2] Baker, H. Kent, "Trading Location and Liquidity: An Analysis of U.S. Dealer and Agency Markets for Common Stocks," *Financial Markets, Institutions, & Instruments*, V.5, N.4 (March 1996), quoting Schwartz, R.A., *Reshaping the Equity Markets: A Guide for the 1990s*, at 127 (1991). (A true and correct copy is annexed hereto as Exhibit C: Trial Exhibit 54.)

[3] "Spread" is the difference between the price paid by the broker and the price charged for it.

[4] *See Penny Stocks: A guide for beginning investors*, 2002 State of Missouri, Matt Blunt Secretary of State. A true and correct copy is annexed to my expert report (Exhibit A hereto) as Exhibit C.

[5] Massimb, M.N and B. D. Phelps, "Electronic Trading, Market Structure and Liquidity," *Financial Analysts Journal*, January-February, 1994, at 41. (A true and correct copy is annexed hereto as Exhibit D: Trial Exhibit 55.)

25. At the time of the Merger, it was generally accepted that greater liquidity resulted in greater economic returns for investors. Considerable academic research has been devoted to this proposition. For example, in 1992, H. Kent Baker and Richard B. Edelman found that "spreads narrow and volume increases after NMS inclusion . . . [and] the evidence suggests that switching to the NASDAQ National Market reduces transaction costs, enhances liquidity and provides higher net returns to investors."[6] A later study by the same authors confirmed that that the move from the over-the-counter Bulletin Board (the "OTCBB") to the NASDAQ National Market is associated with positive returns for the stocks prior to the switch and that the average percentage spread narrows after NASDAQ National Market inclusion, suggesting that liquidity improves.[7]

26. In 1997, Viswanathan, Papaioannou, and Krull found "new evidence that the market reaction to NASDAQ National Market phase-ins is directly related to the reductions in spreads and that the price

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[6] Baker, H. Kent and Richard B. Edelman, "The Effects of Spread and Volume of Switching to the NASDAQ National Market System," *Financial Analysts Journal*, at 83-88 (January-February 1994). (A true and correct copy is annexed hereto as Exhibit E: Trial Exhibit 43.)

[7] Baker, H. Kent and Richard B. Edelman, "OTC Market Switching and Stock Returns: some Empirical Evidence," *The Journal of Financial Research*, V. XIII, N. 4, at 325-38. (A true and correct copy is annexed hereto as Exhibit F: Trial Exhibit 56.)

reaction is positively related to the potential for liquidity gains."[8]

27. One of the most important contributors to the liquidity gains realized by switching from the OTCBB to the NASDAQ National Market is the general availability of information. One of the most important pieces of information regarding a stock is its price. Newspapers, including *The Wall Street Journal*, do not list the prices of OTCBB stocks on a daily basis. *The Wall Street Journal* reports the prices of NASDAQ National Market stocks daily. Inclusion in *The Wall Street Journal* listings automatically gives a stock more visibility and its prices more transparency than if they were not published.

28. In addition to greater liquidity, visibility, and price transparency, the move to the NASDAQ National Market from the OTCBB notifies investors that the company in question has met the more vigorous listing standards of the NASDAQ National Market. The voluntary assumption of the higher standards by the listing firm is generally assumed to indicate a credible signal of managerial confidence that the firm will be able to maintain favorable future

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[8] Viswanathan, K.G., Papaioannou, George, and Krull, Steven, "Testing for Liquidity Gains in the Market Reaction to Nasdaq National Market System Phase-ins," *Quarterly Journal of Business and Economics*, at 49-61(June 1997). (A true and correct copy is annexed hereto as Exhibit G: Trial Exhibit 57.)

performance.[9] Such indications of favorable future performance can positively affect the price of a firm's stock.

29. Other positive aspects of switching from the OTCBB to the NASDAQ National Market include the automatic "marginability" of a firm's stock and its exemption from "Blue Sky" registration requirements.[10] The ability to purchase a security in a margin account is an important feature in expanding its investor base. All other things being equal, a stock that can be margined has a larger potential investor base than one that cannot be margined. A larger potential investor base translates into greater competition for shares which leads to a distinct economic advantage for investors. In general, greater interest leads to lower spreads, and therefore, as shown above, greater returns. Additionally, greater demand increases prices, leading to greater returns.

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[9] Grammatikos, T. and G.J. Papioannous, "The Informational Value of Listing on the NYSE," *Financial Review* 21, at 485-499 (1986). (A true and correct copy is annexed hereto as Exhibit H: Trial Exhibit 58.)

[10] Marginability refers to the ability to purchase a security in a margin account. A margin account is a brokerage account allowing customers to buy securities with money borrowed from the broker. The securities held in the account are used as collateral for loans. "Blue Sky" registration refers to the requirement that companies go through individual registration processes in some states as well as federal registration of securities offerings.

30. Companies that list on the NASDAQ National Market are automatically exempt from Blue Sky registration and are relieved of the burden and expense of such registration. This exemption and the resultant lower costs allow them to raise capital more favorably than would otherwise be the case. All other things being equal, the ability to raise capital at a lower cost translates into increased earnings and higher stock prices.

31. The increased liquidity, signaling of managerial confidence, improved visibility, automatic marginability, and exemption from Blue Sky laws, as well as the Prospectus's frequent mention of the expectation of the NASDAQ National Market listing and the board of directors' consideration of the NASDAQ National Market listing in their decision to recommend the Merger, all support my opinion that the NASDAQ National Market listing was material to investors in Reliant stock.

32. Finally, on August 14, 2002, Reliant filed its Form 10-Q for the period ended June 30, 2002. In that document it stated:

> In May and June of this year, we met with our investment bankers to discuss an underwritten public offering of our common stock. Our investment bankers advised us that we could potentially obtain more favorable pricing for the public offering if we implemented our move to the NASDAQ National Market in conjunction with the underwritten public offering. Over the course of

> June and July we have been preparing for the public offering, but we have recently concluded that present market conditions are no longer favorable for an underwritten public offering of common stock. As such, we are currently evaluating the listing of our common stock on a national market.

See Thane Form 10-Q, for the period ended June 30, 2002, at 12-12 (annexed to the Trial Declaration of Joseph J. Milkowski, as Exhibit C: Trial Exhibit 12).

33. The inclusion of information regarding Thane's failure to list on the NASDAQ National Market System in Thane's Form 10-Q is explicit recognition of the materiality of that information.

Investors Were Misled by the Prospectus

34. The market's reliance on a company's filings with the SEC cannot be overstated. Investors' first and foremost reliance is on a prospectus. Often the prospectus is an investor's first introduction to a company. The rules and regulations of the SEC cause these offering documents to have the most exhaustive explanations of the financial details, operating history, management and other facts of importance to potential buyers of the securities being offered of all SEC filings made by a company. It is common for professional analysts, prior to initiating coverage, to begin their research by reading all of the registration statements and prospectuses included therein filed by a company starting with their initial public offering.

35. The financial community relies on the management of a company to fairly and accurately present information in all of its SEC filings regarding the status and prospects of a company and its stock, including where the stock will trade. It is generally assumed by market participants that prudent company managers recognize the importance of their statements to the financial community and are aware of the impact they will have. Statements by management regarding areas of operation that are clearly within management's control, in light of management's greater knowledge, are viewed as the most reliable source of such information and are extremely important to the market. These statements provide investors with a basis for their investment decisions.

36. Within this context, market participants generally assume that management recognizes how such information will be used, as well as the ramifications if the representations are not accurate. Members of the investment community expect they will not be misled, including being misled by obvious inferences to be made based on management's statements or omissions.

37. The Merger created a new company without a track record on which investors could have relied. Thane was not publicly traded and investors' greatest source of information about it was through the Offering Materials.

38. In addition to giving a list of factors which the board of directors considered in making its

recommendation for approval of the Merger, the Prospectus stated that "[t]he Reliant board of directors also considered a variety of potentially negative factors in its deliberations concerning the merger. . . . " S-4, at 25: Trial Exhibit 2 at THNE 001168. This list does not include any cautionary language regarding the potential failure to list on the NASDAQ National Market. Furthermore, at the end of the above referenced section, the reader was referred to "other risks described above under 'Risk Factors.'" *Id.* In the "Risk Factors" section, there was no mention of the potential failure to list on the NASDAQ National Market. S-4, at 14: Trial Exhibit 53 at THNE 001157.

39. The "Risk Factors" section of the Prospectus contains a list of the potential problems associated with the Merger of which Reliant shareholders should be aware. For example, the Prospectus stated:

> ***There has been no prior public market for the Thane common stock, and therefore Reliant stockholders cannot be certain of the market value of the Thane common stock they will receive in the merger.***
>
> Prior to the merger, there has been no public market for the Thane common stock and there can be no assurance that an active market for the Thane common stock will develop or continue after the closing of the merger. Accordingly, no assurance can be given as to the liquidity of the market for the Thane common stock or the price at which any sales of shares of Thane common stock

> may occur in the future. The price for the Thane common stock will depend, in part, upon a number of factors beyond the control of Thane, including:
>
> - liquidity of the market for the Thane common stock;
> - investor perceptions of Thane;
> - changes in conditions or trends in Thane's industry or publicly traded comparable companies;
> - adverse publicity which Thane may suffer; and
> - general economic and other conditions.

Id. (emphasis in the original).

40. The fact that Thane stock would not list on the NASDAQ National Market was not included in the above list. It was within Thane's control. *See, e.g.*, Exhibit 5 to the Deposition of Mark Taylor. (A true and correct copy is annexed hereto as Exhibit I: Trial Exhibit 5.)

41. Included in the Offering Materials was the "Amended and Restated Agreement and Plan of Merger." Article VI (entitled "Covenants of Thane"), Section 6.5(b) states that:

> Thane shall use commercially reasonable efforts to cause its outstanding Thane Common Stock immediately after the Merger to be approved for quotation on the Nasdaq National Market System or, in Thane's

> reasonable discretion another national securities exchange, subject to official notice of issuance, as promptly as practicable after the date hereof, and in any event prior to the Effective Time.

S-4, Appendix A, at 49: Trial Exhibit 53 at THNE 001361.

42. There is no equivocal language contained in the above statement. The OTCBB is not a national securities exchange, and therefore could not satisfy this covenant of Thane to Reliant. Reliant shareholders had every reason to believe and rely on this covenant.

43. A further indication of the market's expectation that Thane would list on the NASDAQ National Market as soon as it began trading is the lack of market makers able to trade Thane stock when the Merger was effective. On May 24, 2002, when Thane began to trade there was only one market maker.[11] On May 20, 2002, the OTCBB reported that Reliant had 20 market makers when the system opened.[12] I reviewed the OTCBB reports for January 31, February 28, March 28, and April 30 to make certain that May 20 was not an aberration. Reliant had between 21

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[11] *See* Exhibit D to my expert report (Exhibit A hereto) for the OTCBB Market Maker Price Report for Thane.

[12] *See* Exhibit E to my expert report (Exhibit A hereto) for the OTCBB Market Maker Price Report for Reliant.

and 25 market makers listed when the system opened on each of these days.

44. The lack of market makers is telling. In order to make a market in a new security such as Thane, if it had traded on the NASDAQ National Market, a qualified NASDAQ market maker would only have had to notify NASDAQ of its intention to make a market in Thane stock. This could be done electronically and would take effect on the same day.[13] However, in order to begin to make a market in a security such as Thane on the OTCBB, a dealer has to submit Form 211 at least 3 business days before it begins to quote the security. By filing Form 211, a market maker represents that it has fully complied with the information gathering and other requirements of SEC Rule I5c2-11 and NASD Rule 6740. The significant effort required to satisfy these requirements is shown in the documents contained in Exhibit G annexed to my report.

45. A broker/dealer may rely on an exemption from Rule 15c2-11 by satisfying each of six requirements including two-way bid and ask priced quotations that do not reflect customer indications of interest must have been published during the previous 30 calendar days, with no more than four business days in succession without such quotations, in an interdealer quotations system that displays

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[13] *See* Exhibit F to my expert report (Exhibit A hereto) for the *NASD Manual on Line*, Marketplace Rules, Rule 4611(c).

unsolicited customer indications of interest. In other words, the security must have been actively traded for 30 calendar days.

46. Significantly, the only firm making a market in Thane's stock for the first eleven days was William Blair & Co. ("Blair"). Blair was not a disinterested player as it had active interest in helping Thane "go public" in a secondary Offering. *See, e.g.*, presentation to Thane by Blair dated January 29, 2002 at THNE 002050-139 (annexed hereto as Exhibit J: Trial Exhibit 132).

47. On June 24, 2002, Thane still had only two market makers at the time the system opened. Thus, within the first thirty days of its initial trading, only one other market emerged in addition to Blair, Suntrust Robinson Humphrey ("Suntrust"). Suntrust also was not a disinterested market maker as it too hoped to participate in the "going public" transaction. *See, e.g.*, Working Group List for proposed "IPO" (annexed hereto as Exhibit K: Trial Exhibit 139 at THNE0004465). On the next day, June 25, 2002, Thane had two market makers at the time the system opened. Over the course of the day, nine more firms participated in making a market in Thane stock. The following trading day, June 28, 2002, eleven firms are listed by the OTCBB as making a market in Thane stock.

48. Clearly, had these market makers expected that Thane would trade on the OTCBB, they would

have complied with Rule 211 rather than wait for 30 days to trade the stock.

49. In summary, it is my opinion that had the investment community been made aware of the fact that management did not intend to list Thane stock on the NASDAQ National Market immediately following the Merger, shareholders of Reliant would have sold their shares in the open market, realizing more for them than the Thane shares they received were ultimately worth.

I declare under penalty of perjury under the laws of the United States of America that the foregoing is true and correct.

Executed this 22nd day of March, 2005, at Princeton, New Jersey.

/s/ Candace L. Preston
Candace L. Preston

APPENDIX J

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UNITED STATES DISTRICT COURT

CENTRAL DISTRICT OF CALIFORNIA

SOUTHERN DIVISION

HOWARD MILLER, on behalf of himself and all others similarly situated, Plaintiff, vs. THANE INTERNATIONAL, INC., WILLIAM F. HAY, DENISE DUBARRY-HAY, KEVIN MCKEON and MARK TAYLOR, Defendants.	Case No. SA CV 03-1031 JVS (SGLx) CLASS ACTION **TRIAL DECLARATION OF BRADFORD CORNELL** Trial Date: April 12, 2005 Courtroom: 10-C Judge: Hon. James V. Selna

TABLE OF CONTENTS

I.	Introduction	1
II.	Background and Qualifications	2
III.	Overview of Empirical and Theoretical Methodologies	4
IV.	Event Study Analysis	10
V.	Plaintiffs' Criticisms Of My Methods Are Without Foundation	19
VI.	Plaintiffs Overstate The Difference Between The OTC-BB And The OTC-NMS	22
VII.	Alternative Analysis to Determine *Maximum Theoretical* Economic Harm	23
VIII.	Conclusion	30

DECLARATION OF DR. BRADFORD CORNELL

I, Dr. Bradford Cornell, hereby declare:

I. Introduction

1. I have been retained as an expert witness in this action by counsel for defendant Thane International, Inc. ("Thane"). In my Rule 26 expert report,[1] I

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[1] Trial Ex. 44 (Cornell Report). For the convenience of the Court and because of the voluminous nature of the exhibits, I have attached the relevant excerpts from each of the exhibits I mention in my declaration. Complete copies of the exhibits are contained in the joint trial exhibit binders.

provided my opinion on whether the market considered Thane's purported "failure" to list on the NASDAQ over-the-counter National Market System ("OTC-NMS") to be material, and what damages (if any) Thane shareholders suffered as a result of this "failure." The two areas in which I opined were (a) actual legal damages (if any) taking into account the market's reaction to this information, as determined through a comparative event study analysis I performed using standard economic methods; and (b) the *maximum theoretical* economic harm.

2. After applying an economic analysis based on accepted financial methodologies and quantitative methods (described more fully below), I concluded:

(a) The market impounded the information that Thane was trading on the over-the-counter Bulletin Board ("OTC-BB") rather than the OTC-NMS within the first nineteen days after the merger. Because this information did not cause Thane's stock price to drop below the $6.89 consideration paid by Reliant shareholders for the Thane shares received, Thane's shareholders were not damaged as a result of Thane's "failure" to list on the OTC-NMS; and

(b) If I ignored the market's actual response, the *maximum theoretical* economic harm that Thane's shareholders *could* have suffered from the lost liquidity of Thane trading on the OTC-BB rather than the OTC-NMS was $0.40 per share, or $500,066 for all Thane

shareholders collectively, without regard to any legal defenses Thane might have.

3. Counsel for Thane also asked me to respond to the expert report of Candace L. Preston, dated May 20, 2004. In my Rule 26 rebuttal report,[2] I described the fundamental flaws and self-contradictions contained in Ms. Preston's report. The Court dealt with many of these issues in its Orders on Expert Exclusion and Summary Judgment (which I have reviewed), and to the extent the Court has already ruled on these issues, I will not address them in this declaration.

II. Background and Qualifications

4. I am a Professor of Finance and Director of the Bank of America Research Center at the Anderson Graduate School of Management at the University of California, Los Angeles (UCLA) and a Senior Consultant to Charles River Associates. I earned an A.B. in Physics, Psychology & Philosophy from Stanford University in 1970, where I was elected to Phi Beta Kappa. I earned an M.S. degree in Statistics from Stanford University in 1974 and earned my Ph.D. degree in Financial Economics also from Stanford University in 1975.

5. Since 1975, I have taught a variety of courses, including courses involving corporate valuation, the

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[2] Trial Ex. 45 (Cornell Rebuttal Report).

law and finance of corporate acquisitions and restructuring (team-taught with R. Gregory Morgan of Munger, Tolles & Olson LLP), corporate financial theory, and securities valuation and investments. I have also taught at the UCLA Law School. At UCLA, I have twice served as Vice-Chairman of the Anderson School and have twice served as Chairman of the Finance Department. Aside from my teaching responsibilities, I have been active in research. I have written more than 70 articles and two books on finance and securities including *Corporate Valuation: Tools for Effective Appraisal and Decision-Making*, published by McGraw-Hill, and *The Equity Risk Premium and the Long-Run Future of the Stock Market*, published by John Wiley. To complement my academic writing, I have also authored articles for *The Wall Street Journal* and the *Los Angeles Times*.

6. My research has been widely recognized. In 1988, I was cited by the Financial Management Association as one of the ten most prolific authors in the field of finance. I have also received prizes and grants for my research from the Chicago Board of Trade, the Chicago Mercantile Exchange, and the Institute for Quantitative Research in Finance. My article, "Corporate Stakeholders and Corporate Finance," for which my co-author, Alan C. Shapiro, and I received the 1987 Distinguished Applied Research Award from the Financial Management Association, is the most frequently cited article published in Financial Management since 1985. In 1999, I was awarded the I/B/E/S prize for empirical work in

finance and accounting (with Wayne Landsman and Jennifer Conrad.)

7. I have consulted and/or provided expert testimony in over 14 matters involving allegations of securities fraud on behalf of both plaintiffs and defendants, including: *DeLaurentiis Entertainment Group Class Action, In re Hamburger Hamlet Securities Litigation, In re National Medical Enterprises Securities Litigation, Brogren v. Pohlad, Coram v. Caremark, Mittman et al v. Rally's Hamburgers, Inc., In re Assisted Living Concepts, Inc., In re Envoy Corp. Securities Litigation*, and *Estate of Peregrine Systems, Inc.* In addition to securities related matters, I have served as an expert in approximately 47 matters involving other legal concerns such as antitrust, breach of contract, or business valuation matters. I have been qualified to testify in approximately 11 trials over the last 10 years.

8. I have also been active in my profession. I am a past Vice-President of the Western Finance Association. I am also a past director of both the American Finance Association and the Western Finance Association. I have served as an associate editor of numerous professional journals including: *The Journal of Finance, The Journal of Futures Markets, The Journal of Financial Research*, and *The Journal of International Business Studies*. I have served as a reviewer for nearly a dozen other professional journals. I am currently a member of the Pension Policy Board of the Aerospace Corporation.

9. My background is described more fully in my curriculum vitae, which is attached as Exhibit 1 to my opening expert report.[3] Exhibit 2 to my opening report includes a list of my publications over the last ten years.[4]

III. Overview of Empirical and Theoretical Methodologies

10. In conducting my analyses, I considered a number of documents, including Thane's Proxy Statement/Prospectus,[5] news articles and press releases concerning Thane[6] and Thane's SEC filings during the relevant time period,[7] and stock price data for Thane[8]

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[3] Trial Ex. 44 (Cornell Report, Ex. 1).

[4] Trial Ex. 44 (Cornell Report, Ex. 2).

[5] Trial Ex. 28 (Thane's 424B3 Final Prospectus filed with the SEC on April 26, 2002, Bates Nos. THNE 001408 – THNE 001795).

[6] Trial Ex. 51 ("Thane Articles" from Factiva.txt, Bates THNE/CORNELL 000511 – THNE/CORNELL 000551). *See also* Trial Exs. 151, 164, 178-182.

[7] *See, e.g.*, Trial Exs. 17 (Thane's Form 10-K for the fiscal year ended March 31, 2002, filed with the SEC on July 1, 2002) & 12 (Thane's 10-Q for the quarterly period ended June 30, 2002, filed with the SEC on August 14, 2002). I also considered a number of Thane's subsequent SEC filings in conjunction with my rebuttal report, but based on the Court's summary judgment order that there is no evidence that would permit the class to collect damages beyond August 16, 2002, I will not address those issues here.

[8] *See* Trial Ex. 44 (Cornell Report, Exs. 6 & 13).

and for Thane's competitors[9] (the selection process for which is explained below), and the NASDAQ composite index.[10] A full list of the documents I considered is attached as Exhibit 3 to my opening report.[11]

11. For purposes of my analysis, Thane's counsel asked me to assume (i) there was a misstatement or omission in Thane's prospectus concerning listing on the OTC-NMS; (ii) Thane is only liable for damages to shareholders caused by material misstatements or omissions that caused the price to drop below the consideration paid by Reliant shareholders (i.e., the "merger price") and that it is not liable for losses suffered by its shareholders due to other causes; and (iii) the period in which to calculate potential damages is from May 24, 2002 (the first day of public trading after the Thane-Reliant merger) to September 23, 2002 (the day plaintiffs filed their complaint).

12. My analysis can be divided into two principal components, broadly consisting of a theoretical economic analysis – i.e., what is the effect of trading on the OTC-BB as opposed to the OTC-NMS as predicted by economic theory – and empirical observations – i.e., what were the actual, observable effects in this particular case.

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[9] *See* Trial Exs. 48 & 49.

[10] *Id.*

[11] Trial Ex. 44 (Cornell Report, Ex. 3).

13. In the abstract, economic theory posits that the primary value of a company stems from quantifiable measures like its expected discounted cash flow.[12] While market liquidity may affect transaction costs and therefore future cash flows, these costs have a second-order effect on a company's value and in the normal case are quite ancillary. The empirical economic literature, including that cited by plaintiffs, confirms this. For example, in a study conducted by Baker & Edelman of 461 companies that moved from the precursor of the OTC-BB to the OTC-NMS, the mean decrease in average quotation spreads was only 5.7 cents, a difference of less than one percent (0.782%).[13] I have prepared two graphic charts illustrating Baker and Edelman's findings, which are attached as Trial Exhibits 191-D and 192-D.[14] These

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[12] *See* Trial Ex. 150 (R. Brealey & S. Myers, *Principles of Corporate Finance* 75 (7th ed. 2003) ("It doesn't matter whether you forecast dividends per share or the total free cash flow of a business. Value today always equals future cash flow discounted at the opportunity cost of capital.").

[13] *See* Trial Ex. 43 (H. Baker & R. Edelman, *The Effects on Spread and Volume of Switching to the NASDAQ National Market System*, Financial Analysts Journal, January-February 1992, Bates Nos. FMA 002925-FMA 002929).

[14] *See* Trial Exs. 191-D (Average Quotation Spreads Only Changed By $0.057 When Companies Transferred To The NMS From NASDAQ) & 192-D (Average Percentage Spreads Only Changed By 0.782% When Companies Transferred To The NMS From NASDAQ). All Trial Exhibits referenced in my declaration which are denoted with the suffix "D" are demonstrative graphic illustrations which were prepared under my direct supervision and direction.

results conform with what one might expect, as the OTC-BB is still a national market designed for sophisticated broker-dealers who advise their clients and trade for their own accounts, conducting transactions in real time. The OTC-BB is much more like the OTC-NMS than it is different, and, particularly for a company like Thane, which was a small company that just met the minimal requirements for trading on the OTC-NMS during the brief period when it met those requirements, the result of its trading on one over-the-counter market versus another would not be expected to be very different, if at all. Overall, value derives from the company itself and not where it trades, as evidenced by private companies like Bechtel Corp. and McKinsey & Co. which are worth in the billions or hundreds of millions of dollars despite the fact that their shares do not trade on any securities market or exchange.

14. Not only is it true that a company's inherent characteristics are the primary determinants of its value; it is also true that a company's inherent characteristics are the primary determinants of its liquidity. Company-specific factors such as a company's number of shares, its public float, market capitalization, analyst coverage, media coverage, the number of institutional shareholders, and volatility are the primary determinants of the liquidity of a stock, not the market in which the stock trades. Companies like Intel and Microsoft are very widely traded and are very liquid, even though they trade on the OTC-NMS rather than the NYSE, which for a long time was

considered the gold standard for market efficiency. Small companies like Thane have inherent characteristics (high volatility,[15] small public float relative to shares outstanding, low daily trading volume, little analyst and news coverage, and high inside ownership) that play a much greater role in determining a company's liquidity (i.e., its bid-ask spreads) than the market on which the company trades.

15. In order to calculate the *maximum theoretical economic harm* suffered by Thane's shareholders, I implemented an economic model based on the work of Amihud and Mendelson[16] to measure the expected impact of reduced liquidity on Thane's value from trading on the OTC-BB instead of the OTC-NMS. I will explain this model in greater detail below.

16. The other methodology I employed was to take an empirical look at what actually happened in

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[15] One frequently used measure of a stock's volatility is the standard deviation of its daily residual return. The daily residual return is its daily total percentage return (relative price change plus dividend, if any) less the daily total percentage return on an index of comparable companies. In performing my event study of Thane from May 24 to September 23, 2002, I found Thane's daily residual return had a standard deviation of 7.92%, a very high number. *See* Trial Ex. 45 (Cornell Rebuttal Report ¶ 22). By way of comparison the daily standard deviation of Standard & Poors from May 24 to September 23, 2002 was 1.99%.

[16] *See* Trial Ex. 171 (Y. Amihud & H. Mendelson, *Liquidity and Cost of Capital: Implications for Corporate Management*, Journal of Applied Corporate Finance, Fall 1989, Bates Nos. THNE/CORNELL 000747 – THNE/CORNELL 000756).

this case. In looking at the data, one fact stands out: during the first nineteen days after the merger, the price remained above the merger price despite the fact that Thane was trading on the OTC-BB. If the market was able to absorb the fact that Thane was trading on the OTC-BB (as opposed to the OTC-NMS) within these first nineteen days, there would be no damages in this case because the stock's price remained above the merger price (i.e., the effect, if any, of trading on the OTC-BB vs. the OTC-NMS did not cause the price to drop below the consideration paid by Reliant shareholders). Subsequent declines would necessarily be due to factors other than disappointment over where Thane was trading and the anticipated effects of diminished liquidity.

17. A basic tenet of finance theory, and one which plaintiffs ignore, is the proposition that once information is incorporated into the price of a security, its price effect is done.[17] A stock's price will react to new information (whether company-specific or market driven) but it will not continually react to the same information, which is what economists mean when we say that information has been "impounded" into the stock price.

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[17] *See* Trial Exhibit 177 (G. Dent, *Dual Class Capitalization: A Reply to Professor Seligman*, 54 Geo. Wash. L. Rev. 725, 741-42 ("once absorbed, information cannot further influence security prices.")).

18. A primary issue in this case is whether Thane's stock was able to impound information into its stock price. In the abstract there are two extremes: one is that of a perfectly efficient market where information is virtually instantaneously impounded into the stock's price, and the other is a completely inefficient market where price has no quantifiable relationship to information – this can be called an "irrational" market.[18] In point of fact these extremes rarely, if ever, exist, and market efficiency lies on a continuum. A national securities market like the OTC-BB is intrinsically more likely to accurately assess value than most other markets (e.g., the markets for real estate or used cars, where information is clearly not perfectly efficient, but where millions of transactions occur on a monthly basis by people who reasonably assess they know enough to make a major investment decision).

19. The short-hand economists and courts have adopted for these concepts is that of "market efficiency." As noted above, markets are rarely perfectly efficient or inefficient, and the economic literature (including that by Eugene Fama, the father of efficient market theory) posits that markets are efficient with respect to particular information sets.[19]

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[18] *See* Trial Exhibit 152 (W. Sharpe, G. Alexander & J. Bailey, *Investments* 106 (5th ed. 1995)).

[19] *See* Trial Exs. 152 (W. Sharpe, G. Alexander & J. Bailey, *Investments* 105-06 (5th ed. 1995)) & 176 (R. Gilson & R.

(Continued on following page)

A fundamental inquiry is whether Thane could incorporate the fact that it was trading on the OTC-BB (versus the OTC-NMS) into its stock price within the first nineteen days. If it did, then necessarily any other changes in Thane's price were the result of other factors.

20. The fact that a stock is trading on one market versus another is one of the most open and obvious facts one could possibly imagine. Finance theory recognizes that a stock may incorporate some types of information more rapidly than others, resulting in a continuum of efficiency. This continuum can be illustrated by the three forms of the efficient market hypothesis ("EMH") – the weak form, the semi-strong form, and the strong form. The weak form of the EMH holds that current stock prices reflect all past pricing information. Thus, a stock's price on a particular day reflects the information regarding the stock's price on previous days, and no abnormal profits can be made by trading on information contained in those past prices. The semi-strong form of the EMH holds that current stock prices reflect all publicly available information. The strong form of the EMH holds that current stock prices reflect all available information, including non-public information. In the abstract, where a stock trades is much like the past prices at which it has traded –

Kraakman, *The Mechanisms of Market Efficiency*, 70 Va. L. Rev. 549, 558 (1984)).

these are fundamental facts that even the weak form of theory posits would be incorporated into the price.

21. To determine whether these obvious facts were incorporated into the price, I examined two things: (i) whether Thane's stock price moved in response to the overall NASDAQ market and its own submarket information; and (ii) whether Thane's stock price moved in statistically significant ways in response to the release of company-specific information. This analysis included my event study analysis which is described below.

IV. Event Study Analysis

22. I calculated Thane's imputed merger price by multiplying the exchange ratio described in the prospectus (0.3049459 Thane shares for each Reliant share)[20] by Reliant's closing price on May 23, 2002, the last day of trading for Reliant stock before the merger with Thane was completed ($2.10).[21] Thus, each Thane share had an imputed merger price of $6.89 per share. Using Reliant's last publicly traded price is the best way to assess what Reliant shareholders actually paid for their shares since it reflects

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[20] *See* Trial Ex. 28 (Thane's 424B3 Final Prospectus filed with the SEC on April 26, 2002, Bates Nos. THNE 001408 – THNE 001795).

[21] *See* Trial Ex. 174 (Reliant price data from May 20, 2002 through May 24, 2002, from Interactive Data Corp., Bates No. THNE/CORNELL 000812).

the market's best and most recent valuation, and it is my understanding that plaintiffs have stipulated that the market for Reliant's shares was efficient. (Although the differences are not huge, to the extent that Preston's calculations of the merger price are still relevant in light of the Court's prior rulings, my methodology is superior because Preston uses an average figure mentioned in a Form 10-K footnote and the most accurate way to measure what Reliant shareholders paid is to look at how the market valued what they were giving up immediately before the merger.)

23. The fact that Thane was trading on the OTC-BB rather than the OTC-NMS was open and obvious to the market as soon as Thane began trading on May 24, 2002. As plaintiff Howard Miller testified at his deposition, "Any idiot can look at the [electronic quotation] screen and see where's the market."[22] Thane began trading on the OTC-BB on May 24, 2002, and Thane's shares did not begin trading below $7.00 per share until June 12, 2002, nineteen days later. Given the open and obvious nature of this information, I am highly confident that it was impounded into Thane's stock price long before June 12, 2002, notwithstanding the dispute between plaintiffs and defendants concerning how efficient the market for Thane stock was. While highly efficient markets typically take a day or less to incorporate information

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[22] Howard Miller Depo. 60:19-21.

into a stock price, the empirical evidence shows that even a less efficient market like that for Thane was able to incorporate even more complex information within a three-day period. Thus, the drop in Thane's stock price below the merger price after June 12, 2002 must have been caused by factors other than Thane's purported "failure" to list on the OTC-NMS.

24. In order to analyze the possible causes for Thane's stock price decline below the merger price (and in order to confirm that Thane's stock was in fact able to incorporate information into its price), I performed an event study analysis of Thane from May 24, 2002 through September 23, 2002. An event study analysis examines a company's stock price behavior (often relative to a market or industry index) in response to news disclosures such as earnings announcements and the release of analyst reports, if any.

25. To take market and industry conditions into account, I created a market value-weighted index of five comparable companies: Helen of Troy Ltd. (formerly Helen of Troy Corp.), Nautilus Group, Inc. (formerly Direct Focus, Inc.), Cross Media Marketing Corp. (formerly Symposium Corp.), Valuevision Media, Inc. (formerly Valuevision International, Inc.), and Concepts Direct, Inc. I selected these companies based on a number of factors, including: 1) companies that had the same Standard Industrial Classification (SIC) code, Bloomberg Industry Group, and Bloomberg Industry Subgroup as Thane; 2) a review of the deposition testimony of Thane's CEO William Hay;

and 3) a discussion with Mr. Hay. Thane's SIC code was listed as 5961-Catalog and Mail-Order Houses. Thane's Bloomberg Industry Group was Advertising and its Industry Subgroup was Direct Marketing.[23]

26. My primary criterion in selecting the comparable companies was that they compete in the same industry areas with similar products through similar distribution channels. I strove to be complete as possible to avoid "cherry picking." I value-weighted the index in order to reflect accurately the relative size of the comparable companies that comprise the industry in question. My selection criterion and value weighting of the companies selected employed standard, recognized economic principles and methods.

27. My event study analysis confirmed that Thane's stock was indeed able to incorporate general market, industry, and company-specific information into its stock price. For example, between May 24, 2002 and June 24, 2002, Thane's stock price declined 29%, while the NASDAQ Composite Index declined 12%, and my value-weighted index of Thane's competitors

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[23] *See* Trial Exs. 160 (Bloomberg QSRC Search, Bates Nos. THNE/CORNELL 000001 – THNE/CORNELL 000006), 162 (Computer print-out from www.osha.gov., retrieved on May 26, 2004, providing an SIC Description for 5961: Catalog and Mail-Order Houses, Bates No. THNE/CORNELL 000012) & 163 (Computer print-outs from Bloomberg L.P. with comparative company data, retrieved on May 27, 2004, Bates Nos. THNE/CORNELL 000013 – THNE/CORNELL 000024). Provell, Inc. was also listed as a comparable company but trading data were not available during the relevant period.

declined 20%. Thus, as illustrated by Trial Exhibit 188-D (a graphic chart I prepared comparing Thane's stock price with the relevant indices), in the first month after the merger, most of the decline in Thane's stock price can be explained by general market and industry factors. *See* Trial Ex. 188-D (Thane International vs. Value Weighted Peer Group And NASDAQ Composite Indices, May 24, 2002 – June 24, 2002).

28. My event study analysis also confirmed that Thane's stock was able to impound company-specific information, and that such information accounted for an even greater portion of the decline in Thane's stock price. On August 14, 2002, Thane announced its earnings for the quarterly period ended June 30, 2002. These earnings were $0.07 per share, whereas Thane's earnings for the quarter ended June 30, 2001 were $0.13 per share. Over a three-day trading period, Thane's stock price dropped from a closing price of $3.60 per share on August 13, 2002 to a closing price of $ 1.95 per share on August 16, 2002, a decline of approximately 46%. Thus, Thane's stock price declined in direct proportion to its adverse earning announcement, indicating that the market for Thane's stock was able to rationally and accurately price Thane's stock. I have prepared Trial Exhibit 190-D, which is a graphic chart illustrating these proportional declines. *See* Trial Ex. 190-D (Thane's Stock Price Decline After The August 14, 2002 Earnings Announcement Was In Proportion To The Announced Decrease In Earnings Per Share).

Although this price adjustment took a period of three days rather than the one day that is generally expected for stocks that are semi-strong form efficient, the fact that Thane's market was able to impound this somewhat more complex information over the course of 72 hours gives me considerable confidence that Thane's stock impounded and reflected the impact of trading on the OTC-BB rather than the OTC-NMS (a rather more open and obvious fact) within nineteen days.

29. There are three reasons for this confidence. First, consider the fact that to absorb Thane's disappointing quarterly results, the market had to compare this small company's publicly reported results with its prior year. Broker-dealers and other sophisticated buyers and sellers had to read the Form 10-Q and draw their best conclusions about what it meant for Thane's present value and its future prospects. While that is not terribly difficult, it still requires much more effort than simply looking at which electronic exchange the stock is trading on. Second, the time involved. It took only three days for the financial results to be fully impounded: for there to be a finding of no damages in this case the market had the almost leisurely benefit of nineteen days. Finally, economic theory plays a role; for all the reasons discussed above (value is primarily reflective of anticipated cash flow, liquidity is more closely tied to the inherent characteristics of the company than the market upon which it trades) economic theory predicts that there would not be a big effect to Thane trading on the

OTC-BB as opposed to the OTC-NMS, and the observable facts confirm this prediction.

30. It is my understanding that plaintiffs take the position that while the market may have been fully aware that Thane was trading on the OTC-BB, that such information may not have been incorporated in the price. From an economists' point of view, this presents an irreconcilable contradiction. A market may not be perfectly efficient and therefore it may take some time to absorb a piece of information. For example, it may take some time for the market to digest certain complex information in the footnotes to an earnings disclosure. However, once the information has been absorbed, the information can no longer have a continuing effect on the price. The plaintiffs' notion that the market was fully aware that Thane was trading on the OTC-BB rather than the OTC-NMS, but that the information continued to have an effect on Thane's stock price for a period of weeks and even months contradicts basic principles of finance theory.

31. It is my further understanding that plaintiffs attempt to draw a distinction between the fact that Thane was trading on the OTC-BB rather than the OTC-NMS, and the question of whether Thane intended to honor its supposed promise to list immediately on the OTC-NMS. This is the so-called "management credibility" issue. Again, from an economist's point of view, these are not two separate events. There would be but one price effect if there were

any. The "management credibility" adjustment would occur simultaneously with the (presumed) disappointment over the loss of the anticipated OTC-NMS listing.

32. I understand that plaintiffs' expert, Candace Preston, has opined on the supposed "materiality" of Thane's not listing on the OTC-NMS. I have reviewed plaintiffs' and defendants' summary judgment and expert exclusion filings, Preston's Rule 26 report, deposition testimony, and declaration submitted in opposition to defendants' motions for summary judgment and expert exclusion, and I have the following comments. First, plaintiffs and Preston speak about materiality as being totally divorced from the prices of Thane's stock, which are said to be "irrelevant" and "meaningless." From an economic and financial analysis perspective, that is absurd. Unless one has an objective baseline from which to measure (i.e., prices), statements about materiality are just unsupportable opinions. Second, on her own terms, Preston's materiality opinion is internally inconsistent because it presents multiple occasions when the market supposedly considered (and reconsidered) Thane's "failure" to be material, whereas finance theory predicts that once the market had absorbed the information it would be done with it – there would not be a continuing, lingering "materiality" effect.

33. Preston opined that the market gave Thane a ten-day grace period before it began to make a price

adjustment to Thane's purported "failure" to immediately list on the OTC-NMS.[24] There are two fundamental problems with this theory. First, the ten-day period is arbitrary, and it appears that Preston merely selected a day on which, in retrospect, Thane's stock began to decline. This type of analysis assumes the very conclusion it is attempting to prove, namely that the price decline beginning on June 3, 2002 was attributable to Thane's "failure" to "immediately" list on the OTC-NMS. Second, even if one were to assume that the market for some unknown reason decided to give Thane that ten-day "grace period," then Thane's stock price should have been penalized at the end of that period. Thus, if one were to accept Preston's theory, this would mean that the market had fully incorporated Thane's "failure" to "immediately" list by June 4, 2002 at the latest.

34. On June 24, 2002, Thane's stock price closed at $6.00 per share. On June 25, 2002, Thane announced its earnings for its fiscal year 2002 and its stock price closed at $5.25 per share. This announcement was Thane's first earnings announcement as a public company. Plaintiffs' expert has stated that "the 'news' in [the June 25, 2002] announcement was that there wasn't any news regarding why Thane had not switched to the NMS. No news in this case was not good news. The lack of an explanation left the market with concerns regarding the reason for the failure to

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[24] Preston Report ¶ 50.

list and with management credibility questions."[25] It is pure speculation (and highly implausible) to posit that it was (as of June 25, 2002) this month-old promise to "immediately" list on the OTC-NMS as opposed to Thane's just-released financial results that led to the price decline.

35. Thane's earnings announcement indicated that it earned $9.9 million in net income for fiscal year 2002 ($0.30/share) as opposed to $16.0 million in fiscal year 2001 ($0.50/share).[26] Although most of this difference was due to a non-recurring charge (which Thane reported had an impact of approximately $5.7 million on net income and $0.18 on net income/share), Thane's net income was still $0.4 million lower and net income/share was $0.02 lower. (The non-recurring charge was due to a refinancing of prior credit facilities, resulting in Thane recording approximately $9.1 million in non-recurring interest expense.) If the June 25 price decline was a "reaction" to anything, it was likely a response to this information in Thane's earning announcement.

36. Moreover, on June 25, 2002, nine additional market makers began trading Thane stock (for a total

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[25] Preston Report ¶ 51. (The Court's March 3, 2005 Order excluded as inadmissible all of paragraph 51 from Preston's Report except for the first two sentences to the extent those sentences address materiality issues, and prohibited any use of that portion of Preston's Report as evidence of damages.)

[26] *See* Trial Ex. 151 (Press release issued by defendant Thane on June 25, 2002, appearing on Bloomberg newswire).

of eleven), in light of which Ms. Preston cannot credibly assert that market makers were so concerned that Thane's stock was not listed on the OTC-NMS that they refused to trade it. Moreover, Thane's average inside spread declined from 15.86% on June 24 to 7.69% on June 25, a sign that Thane's liquidity had improved.[27]

37. If one accepts Ms. Preston's assertion that "Thane's chances of a NMS listing . . . were quickly evaporated as a result of the lack of disclosure [on June 25, 2002] regarding its failure to list on the NMS,"[28] then Ms. Preston should have ended her damages analysis period as of that date (as she should have on the prior June 4 date, at the end of the purported 10-day period the market gave Thane to list). According to Ms. Preston's analysis, the market knew as of June 25, 2002 (as it knew as of June 4, 2002) that Thane's stock traded on the OTC-BB and that it had no chance of listing on the OTC-NMS. Assuming this to be the case, any subsequent decline in Thane's stock price below $5.25 had to have been caused by factors other than where Thane was trading.

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[27] *See* Trial Exs. 45 (Cornell Rebuttal Report ¶ 42) & 168 ("Thane International, Inc., Real-Time Inside Spread Data", Bates Nos. THNE/CORNELL 000579 – THNE/CORNELL 000582).

[28] Preston Report ¶ 51. *See* footnote 25, *supra*.

38. On June 26, 2002, Thane's stock price closed at $5.00. On June 28, 2002, Thane's stock price closed at $4.80. At no point after June 28, 2002 did Thane's stock price ever reach the $5.00 level. At this point in time, over one month after the merger and with the price below the $5.00 minimum requirement for listing on the OTC-NMS, it is beyond reasonable dispute that the market had absorbed the fact that Thane was not going to "immediately" list on the OTC-NMS, and the market (even on Preston's terms) would have to have assimilated the fact that a listing on the OTC-NMS was highly unlikely.

39. Subsequently, Thane's stock price declined from $4.80 on June 28, 2002 to $3.60 on August 13, 2002, a decline of 25%. During this same time period, the value-weighted index of Thane's competitors declined 13%, and the NASDAQ Composite Index declined 13%. Trial Exhibit 189-D (Thane International vs. Value Weighted Peer Group And NASDAQ Composite Indices, June 28, 2002 – August 13, 2002) illustrates these comparable declines. General market and industry forces again accounted for a large portion of Thane's decline during this time period. Thus, when one factors out the two periods during which Thane released company-specific information (i.e., following the June 25 and August 14 announcement), Thane traded quite closely to its comparable company index and the overall NASDAQ. Trial Exhibits 188-D and 189-D graphically illustrate this.

40. On August 14, 2002, Thane announced its earnings for the quarterly period June 30, 2002. As

discussed above, Thane's stock price dropped 46% from $3.60 on August 13, 2002 to $1.95 on August 16, 2002. As illustrated in Trial Exhibit 190-D (a graphic chart I have prepared), this price decline was almost in exact proportion to the decline in Thane's earnings for the same period in the previous year. In light of Thane's demonstrated price sensitivity to industry factors previously, it is reasonable to attribute the price decline between $3.60 and $1.95 to Thane's adverse earnings announcement.

41. I understand that the Court in its Order on Summary Judgment stated that I "admitted" that it could have taken until August 16, 2002 for the information concerning Thane's decision not to list on the OTC-NMS to be incorporated into Thane's stock price. I do not believe my testimony supports that statement, and in any event I want to be sure my testimony is clear on this point. On August 14, 2002, Thane announced at least two pieces of information: first, the adverse earnings information I have already discussed, and second, an explanation of why Thane had not listed on the OTC-NMS. When I said at my deposition that it may have taken a period of days for Thane to incorporate the information in the August 14 earnings announcement, I was stating that it might take that long to impound the adverse earnings information, not the already stale information concerning Thane's "failure" to list immediately on the OTC-NMS. I have always tried to be clear that in my professional opinion, Thane's purported "failure" to list on the OTC-NMS was already impounded into

Thane's stock price within the first nineteen days after the merger.

42. In my expert rebuttal report, I provided a further discussion of some of the factors responsible for the decline in Thane's stock price after August 16, 2002. *See* Trial Ex. 45 (Cornell Rebuttal Report ¶ 42). In light of Court's ruling on Summary Judgment that there is no evidence that would permit the class to collect damages beyond August 16, 2002, I will not address those issues here.

V. Plaintiffs' Criticisms Of My Methods Are Without Foundation

43. Plaintiffs have leveled a number of criticisms against my event study analysis. One of these criticisms, the notion that my analysis somehow ignores the issue of management credibility, has already been addressed. As I explained, any loss of management credibility associated with the failure to list immediately would have been impounded into Thane's stock price at the same time as the market incorporated Thane's purported "failure" to deliver on a material promise to immediately list on the OTC-NMS. Thus, my event study analysis fully takes into account any issues of management credibility resulting from Thane's trading on the OTC-BB rather than the OTC-NMS.

44. Plaintiffs have also asserted that "efficiency" is a prerequisite to conducting a valid event study. Plaintiffs argue that because I testified that I

made no determination whether or not Thane was efficient pursuant to the criteria of *Cammer v. Bloom*, it was inappropriate and misleading for me to use an event study. However, it was simply not necessary to make a determination of *Cammer*-like efficiency in this case because the issue was not whether Thane could immediately impound information into its price. Instead, the issue here is much more simple. If Thane's price incorporated where it was trading within the first nineteen days after the merger – a considerable length of time for a very open and obvious fact – there are no legally cognizable damages. Thane does not have to demonstrate nearly perfect *Cammer*-like efficiency for me to be able to make confident conclusions on that score.

45. As I have explained, economists recognize that efficiency is a continuum, and markets are rarely perfectly efficient or completely inefficient. An event study is one of the tools that economists use to determine where on the continuum of efficiency a particular market lies.[29] Thus, an event study does not require a predetermination that a market is efficient, and instead can be used to test whether the market for a particular stock is capable of absorbing information, and how quickly it does so. In fact, the fifth *Cammer* factor – whether or not there is a cause-and-effect relationship between company-related

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[29] Trial Ex. 153 (W. Sharpe, G. Alexander & J. Bailey, *Investments* 97 (6th ed. 1999)).

news and a stock's price – can be read as requiring a quantitative event study *in order to determine* whether or not a stock is efficient. The notion that efficiency is a *prerequisite* to performing an event study is inconsistent with this aspect of *Cammer*.

46. Plaintiffs have claimed that my event study was not valid because it did not use a regression analysis. However, while a regression analysis can be a helpful analytical tool, it was inappropriate here because there was no "clean" pre-issuance period to provide a baseline. Nevertheless, the fact that a regression analysis was not appropriate does not mean that no quantitative tools were available to determine if the market for Thane's stock was capable of absorbing information. Finance theory is not so limited. When a regression analysis cannot be performed, the use of in-sample descriptive statistics like my event study analysis is a generally accepted method for determining which residual returns lie at the extremes of the range and are thus statistically significant.

47. My event study analysis employed a market-adjusted residual return methodology that has been generally accepted in the finance literature for approximately twenty years. This methodology was originally described by Brown & Warner, and even the Haleblian & Finkelstein article[30] cited by

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[30] Trial Ex. 154 (J. Haleblian & S. Finkelstein, *The influence of organizational acquisition experience on acquisition*

(Continued on following page)

plaintiffs acknowledges that using the market-adjusted return methodology is preferable in some circumstances to using a return that is both risk- and market-adjusted.

48. Plaintiffs also claim that the results of my event study may not be relied upon because Thane's stock sometimes declined by statistically significant amounts in the absence of any new information. However, it has long been recognized in the finance literature that stocks trading even in highly efficient markets like the NYSE or the AMEX experience statistically significant price changes that are not explained by market, industry, or company-specific factors.[31] The term for such unexplained changes in financial economics is "noise." Even though there may be some noise in a stock's price history, a financial economist can still determine that its prices have impounded the effects of new information. Further, once a stock begins to trade at lower dollar levels, its returns become more volatile because a smaller dollar change in its price translates into a larger percentage change, or return.

49. Plaintiffs misinterpret the significance of this phenomenon and have erroneously stated that I have testified that Thane's price movements were "meaningless" once its stock began trading at or

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performance: a behavioral learning perspective, Administrative Science Quarterly, March 1999, at 11-12).

[31] Trial Ex. 155 (R. Roll, R^2, Journal of Finance, July 1988).

below $5.00. This mischaracterizes my testimony. I stated that "there is going to be lots of days with big returns, and you won't have a clue why" once Thane's stock price dropped down to the $5.00 level. [Cornell Depo. 80:20-24] This statement does not mean that all of Thane's price movements were "meaningless" after its price reached $5.00. Rather, it means that these movements have to be examined more carefully to ascertain their cause, if any. For instance, when Thane's price reaction to its August 14, 2002 earnings announcement is analyzed, it quickly becomes apparent that Thane's stock price declined almost exactly proportionately with Thane's reduced earnings[32] and that this price decline was meaningful.

VI. Plaintiffs Overstate The Difference Between The OTC-BB And The OTC-NMS

50. In her declaration in opposition to defendants' motions for summary judgment and expert exclusion, Preston quoted certain statements regarding the OTC-BB from its web site, and, in my opinion, she attempts to overstate the differences between the OTC-BB and the OTC-NMS. For instance, she states that "[i]nvestors must contact a broker/dealer to trade OTCBB securities. Investors do not have direct access to the OTCBB service."[33] While this is true, Preston ignores the fact that investors must also contact a

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[32] *See* Trial Ex. 190-D.

[33] Preston Decl. at 5, ¶ 7.

broker/dealer to trade securities that are listed on the NMS. Her statement that the "NASDAQ National Market System is a respected, desirable trading venue and the OTC-BB is known throughout the investment community as a 'cowboy' market"[34] ignores the similarities between the two markets. For example, in her Expert Report, Preston discussed Reliant, Thane's predecessor, as an example of a stock that traded in a liquid market.[35] Yet, she admitted that Reliant traded on the OTC-BB.[36] Moreover, plaintiffs have stated in discovery their position that prior to the merger, Reliant – an OTC-BB stock and one that was much smaller than the combined Reliant-Thane entity – was an efficient stock. Therefore, for plaintiffs to be consistent, trading on the (supposedly) "cowboy market" OTC-BB cannot necessarily mean that a stock did not trade efficiently. Both the OTC-BB and the OTC-NMS are over-the-counter markets in which computers link buyers, sellers, and market makers; public companies must file periodic reports with the SEC and other regulatory bodies regardless of where they trade; and real time quotes are readily available for both OTC-BB and OTC-NMS securities. In short, these two markets are more similar than they are different.

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[34] Preston Decl. at 5-6, ¶ 8.

[35] Preston Report ¶ 44. In paragraph 44 of her expert report, Preston admits that Reliant traded in a liquid market. The Court specifically excluded this portion of her report as unreliable for expert purposes.

[36] Preston Report ¶ 35.

VII. Alternative Analysis to Determine Maximum Theoretical Economic Harm

51. In the second part of my analysis, I ignored the market's actual response, and instead used economic theory to predict the maximum theoretical economic harm that *could* have been caused to Thane's shareholders due to reduced liquidity from trading on the OTC-BB rather than the OTC-NMS. (As noted above, this does not mean that the stock actually did suffer those consequences – merely this is the outer edge of the theoretical damages that finance theory would predict might occur.)

52. A stock's liquidity refers to the cost and ease with which it can be sold.[37] In formulating my opinions, I considered the work of Amihud and Mendelson,[38] in which they posit that the expected impact of reduced liquidity on a security's value can be measured by the present value of the incremental transactions costs brought about by the reduced liquidity to all shareholders who ever trade the security into perpetuity. Inherent in this model is the assumption

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[37] *See* Trial Ex. 175 (Z. Brodie A. Kane & A. Marcus *Investments* (2002), Bates Nos. THNE/CORNELL 000813 – THNE/CORNELL 000815).

[38] Trial Ex. 171 (Y. Amihud & H. Mendelson, *Liquidity and Cost of Capital: Implications for Corporate Management*, Journal of Applied Corporate Finance, Fall 1989, Bates Nos. THNE/CORNELL 000747 – THNE/CORNELL 000756). *See also* Trial Ex. 47 (Y. Amihud *Illiquidity and stock returns: cross-section and time-series effects*, Journal of Financial Markets, Vol. 5, 2002).

that reduced liquidity results in higher incremental transactions costs, i.e., bid-ask spreads.[39] This approach to measuring economic harm also takes into account any higher spreads that could potentially result from having a small public float and no analyst coverage.

53. In implementing Amihud and Mendelson's model, I examined the effect of a change in annual transactions costs (as measured by bid-ask spread multiplied by annual turnover) upon the stock of a hypothetical company whose entire cash flow per share consisted of a $1 dividend received each year into perpetuity. (This is just a way of establishing a baseline, so that one can compare only the effects of trading on the OTC-BB as opposed to trading on the OTC-NMS.) The value of this company's stock is its cash flow per share divided by its cost of equity capital. A company's cost of equity capital is the annual return on the company's stock that is expected

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[39] The bid-ask spread for a stock, particularly one traded in a negotiated market like the OTC-NMS or the OTC-BB, is the difference between the price at which a market maker is willing to purchase the stock from an investor who wishes to sell the stock (bid price) and the price at which the market maker is willing to sell the stock to an investor who wishes to purchase the stock (ask price). This spread represents the amount of profit earned by the market maker on a round-trip transaction in a security (purchase and sale). A wider bid-ask spread relative to a stock's price indicates a less liquid stock because it costs more to purchase and sell the stock, thus providing both current and potential investors with a disincentive to change the status quo and either sell or purchase the stock.

by its shareholders over time to compensate them for the time value of their money and the non-diversifiable risks involved in holding the company's stock.

54. In this analysis, I assumed that this hypothetical company's cost of equity capital is equal to Thane's cost of equity capital at the time of its merger with Reliant and subsequent share exchange. I used a technique that is well known in theoretical finance for estimating Thane's cost of equity capital known as the Capital Asset Pricing Model (CAPM). The key assumptions behind the CAPM are as follows:

- Investors are naturally risk-averse, i.e., they expect to be compensated for bearing additional risk, which is defined as variability of future returns;
- Investors can earn the risk-free rate on risk-less assets, i.e., government securities.
- All firm-specific risk (unsystematic risk) can be diversified away by holding stocks in the context of a group, or portfolio, and the fact that these stocks do not move in perfect tandem with each other, i.e., are not perfectly positively correlated, helps to smooth out price fluctuations in individual stocks over time and reduce the risk, or variability of future price returns, to the shareholder,
- Beta is a measure of a stock's movement in relation to that of the market as a whole;

- The market consists of all risky assets available to investors and is assumed to move in perfect tandem with itself, i.e., its beta is one;

- Because the market consists of all risky assets, investors investing in the market portfolio demand a higher return than if they were investing in risk-free assets. In other words, they demand a risk premium in order for investing in the market portfolio to be attractive to them;

55. Exhibit 7 of my opening report[40] shows my calculation of Thane's cost of equity capital as of the time of its merger with Reliant. I calculated Thane's forward-looking cost of equity capital to be 12.83%. In calculating this number, I began with the average monthly 20-Year constant maturity Treasury bond rate of 5.81% as my proxy for the risk-free rate.[41] I multiplied my estimate of the long-term forward-looking equity risk premium for the market as a whole of 5.50%[42] by Thane's forward-looking BARRA

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[40] Trial Ex. 44 (Cornell Report, Ex. 7).

[41] *See* Trial Ex. 169 (Computer print-out from www.federalreserve.gov of interest rate data, retrieved on Nov. 25, 2003, Bates Nos. THNE/CORNELL 000583 – THNE/CORNELL 000593).

[42] My estimate of the long-term forward-looking equity risk premium is a conservative (i.e., high) estimate that, if anything, favors plaintiffs. For example, in a 2001 article, Professor Ivo Welch of Yale surveyed 510 finance and economics professors and found that the consensus forecast for the 30-year arithmetic equity premium was about 5 to 5.5%. Trial Ex. 172 (I. Welch,

(Continued on following page)

beta of 1.28[43] and added this adjusted risk premium to my 5.81% risk-free rate estimate to arrive at 12.83%.

56. Returning to my model, if the hypothetical company's stock could be traded without incurring transaction costs, its value per share to shareholders would be $7.79, or the present value of the $1 dividend into perpetuity when it is divided by the company's 12.83% cost of equity capital. This calculation can be found in Exhibits 8 and 9 of my opening report,[44] which detail the calculations of the diminution in value to this hypothetical stock caused by transactions costs involved in trading it, depending upon whether it is assumed to trade on the OTC-BB or the OTC-NMS. I assumed that the hypothetical company

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The Equity Premium Consensus Forecast Revisited, September 8, 2001, Bates Nos. THNE/CORNELL 000757 – THNE/CORNELL 000770). In 2001, Professors J.R. Graham and Campbell Harvey did a survey of corporate chief financial officers and found their 10-year risk premium estimates to range between 3.6% and 4.7%. Trial Ex. 173 (J.R. Graham and C. Harvey, *Expectations of Equity Risk Premia, Volatility and Asymmetry from a Corporate Finance Perspective*, Working Paper October 9, 2001, Bates Nos. THNE/CORNELL 000771 – THNE/CORNELL 000808).

[43] BARRA is a private entity that is like Standards and Poors in that it sells its, proprietary calculations of financial metrics to professional organizations, primarily financial institutions. *See* Trial Ex. 165 (Document from the Barra Beta Book, copyright 2003, Bates No. – THNE/CORNELL 000026).

[44] Trial Ex. 44 (Cornell Report, Exs. 8 & 9).

trades on the OTC Bulletin Board and that its bid-ask spread is 11%.[45]

57. I derived this spread by examining real-time intra-day data for Thane on June 5, 2002 (the first trading day for which such data are available) and finding that its average bid-ask spread as a percentage of the bid price was approximately 11%.[46] I used Thane's bid price as the denominator because it represents the price at which a Thane shareholder who received stock in the exchange offer would have been able to sell those shares to a market maker in order to dispose of his or her holdings. I used the earliest possible trade date because I wanted to get a measure of Thane's bid-ask spread using intra-day data as soon as possible after it started trading in the public market.

58. I also used Thane's annual turnover as a measure of the hypothetical company's annual turnover if it had traded on the OTC-BB.[47] I determined that Thane's actual annual turnover was 0.70838 in its first year of trading. I calculated this number by looking at Thane's actual annual trading volume from

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[45] *See* Trial Ex. 44 (Cornell Report, Ex. 8).

[46] I confirmed this by computing the average real-time spread for Thane between June 5 and June 28, 2002. Thane's average real-time spread during June 2002 was 11.03%. *See* Trial Ex. 168 ("Thane International, Inc., Real-Time Inside Spread Data", Bates Nos. THNE/CORNELL 000579 – THNE/CORNELL 000582).

[47] *See* Trial Ex. 44 (Cornell Report, Ex. 8).

May 24, 2002 through May 23, 2003 and dividing it by Thane's public float.[48]

59. In order to calculate the present value of transactions costs into perpetuity for trading this hypothetical company, I calculated its annual transactions costs by multiplying its bid-ask spread by its annual turnover. I then took the annual transactions costs for 66 years to simulate perpetuity and discounted these annual amounts to the present value and used Thane's cost of equity capital of 12.83% as the discount rate. This hypothetical company is therefore assumed to trade on the OTC-BB with a bid-ask spread and annual turnover equal to that of Thane.[49] Consequently, its stock would trade at a discount of 37.80% from its frictionless value of $7.79 per share, or at $4.85 per share with transactions costs.

60. In Exhibit 9 of my opening report,[50] I assumed that this hypothetical company was listed for trading on the OTC-NMS. Consequently, I expected that such a company would have lower incremental transactions costs, i.e., a lower-bid-ask spread, and a higher annual turnover rate. Here, I researched the financial literature and found that a study by Chan,

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[48] Supporting calculations may be found as Exhibit 10 of my opening report. Trial Ex. 44 (Cornell Report, Ex. 10).

[49] *See* Trial Ex. 44 (Cornell Report, Ex. 8).

[50] Trial Ex. 44 (Cornell Report, Ex. 9).

Christie, and Schultz[51] had the lowest inside spread (highest bid, lowest ask) of $0.16 for a sample of 18 stocks. The minimum stock price in this sample was $3.69 per share. I used this $0.16 spread as a percentage of the $7.79 frictionless value that I computed in my model and arrived at 2.05%.

61. Given the low initial price per share and small public float of Thane's stock, I felt that my estimate of Thane's hypothetical bid-ask spread had it been listed on the OTC-NMS was very conservative (i.e., if anything it favors plaintiffs). I then found that the turnover for stocks listed on the NASDAQ stock market as a whole was 2.94 times per year in 2001,[52] the last full year for which data were available before Thane's stock traded. I estimated the annual transactions costs for the hypothetical company in Exhibit 9 of my opening report[53] by multiplying its hypothetical NMS bid-ask spread by its annual hypothetical NASDAQ turnover. I then discounted these annual transactions costs for 66 years (to simulate perpetuity) back to the present value at Thane's cost of equity

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[51] Trial Ex. 167 (K.C. Chan, W. Christie & P. Schultz, Market Structure and the Intraday Pattern of Bid-Ask Spreads for NASDAQ Securities, Journal of Business, January 1995 Bates Nos. THNE/CORNELL 000552 – THNE/CORNELL 000578).

[52] *See* Trial Ex. 170 (Frank Getz's Equities Perspective May 17, 2002, Bates Nos. THNE/CORNELL 000594 – THNE/CORNELL 000595). Mr. Getz is Chief Technical Analyst with Shields & Company, a brokerage firm based in New York City.

[53] Trial Ex. 44 (Cornell Report, Ex. 9).

of 12.83%. I thus found that the net effect on this hypothetical company's frictionless value of trading on the OTC-NMS was 32.00%.

62. I then applied the discounts calculated in Exhibits 8 and 9 of my opening report[54] to Thane's imputed merger price of $6.89, which is the value of what Reliant shareholders gave up in the exchange. I estimate that listing on the OTC-NMS as opposed to the OTC-BB would have added no more than $0.40 in value per share to Thane's stock price.[55]

63. My final step in my analysis was to apply this $0.40 per share amount to real-time intraday trading data for Thane from May 24, 2002 through September 23, 2002, the date that plaintiffs filed their complaint in this action, to determine how many Thane shares potentially could have been harmed by Thane's failure to list on the NMS. I assumed that 1,318,106 shares were eligible for damages.[56] I reduced the amount of Thane shares eligible for damages on a daily basis by the tick-by-tick trading volume over the period May 24, 2002 through September 23, 2002 and only counted as potentially harmed those shares that traded at prices below $6.89 per share (Thane's imputed merger price). I

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[54] Trial Ex. 44 (Cornell Report, Exs. 8 & 9).

[55] Supporting calculations may be found as Exhibit 11 of my opening report. Trial Ex. 44 (Cornell Report, Ex. 11).

[56] Supporting calculations may be found as Exhibit 12 of my opening report. Trial Ex. 44 (Cornell Report, Ex. 12).

limited the maximum economic harm per share to $0.40 because this was the maximum theoretical economic harm per share that Thane's shareholders theoretically could have suffered as a result of Thane's trading on the OTC-BB as opposed to the OTC-NMS. If the difference between the actual trading price and Thane's imputed merger price was less than $0.40, I used that difference as the measure of maximum theoretical economic for the shares involved in that trade. I then multiplied the remaining Thane shares eligible for damages that did not trade between May 24 and September 23, 2002 by the maximum theoretical economic harm per share of $0.40 to calculate the maximum possible economic harm for Thane shares that were held through September 23, 2002. I calculated that the maximum possible economic harm to Thane shareholders clue to Thane's failure to list on the NMS was $500,066.[57]

VIII. Conclusion

64. Thane's trading price remained above the merger price for nineteen days after it began to trade publicly, and the fact that it traded on the OTC-BB was open, obvious and therefore widely known to the market from the very beginning. Despite the market's knowledge about where a market for Thane's stock was being made (i.e., the OTC-BB as opposed to the

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[57] Supporting calculations may be found as Exhibit 13 of my opening report. Trial Ex. 44 (Cornell Report, Ex. 13).

OTC-NMS), Thane's stock traded above the merger price for nearly three weeks after the merger, meaning that Thane's subsequent decline had to have been caused by factors other than where it traded. Further, my event study analysis of Thane from May 24 through September 23, 2002 shows that Thane's price decline to levels below its merger price was not caused by its trading on the OTC-BB as opposed to the OTC-NMS. Rather, this decline can be accounted for by prevailing market and industry conditions and by an adverse sales and earnings announcement by Thane itself. Consequently, Thane's shareholders were not damaged under Section 12(a)(2) of the Securities Act of 1933.

65. Even if one ignores the requirements of Section 12 and focuses on maximum theoretical economic harm due to lost liquidity, the maximum amount by which Thane shareholders could have been harmed by Thane's failure to list on the OTC-NMS is $500,066. I note once again, however, that this figure does not reflect what actually happened in this case which is that there were no damages because after the market impounded where Thane was trading, it still was above the consideration paid by Reliant shareholders. Instead those calculations can be thought of as a sanity check on what the empirical data tells us, which is that this issue was not material to the market and that Reliant shareholders suffered no legal damages.

I declare under penalty of perjury under the laws of the United States of America and the State of California that the foregoing is true and correct. Dated this 29th day of March 2005 at Pasadena, California.

By /s/ Bradford Cornell
Bradford Cornell

APPENDIX K

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA
SOUTHERN DIVISION

HOWARD MILLER, on behalf of himself and all others similarly situated,	)	Case No. SA CV 03-1031 JVS (SGLx)
Plaintiff,	)	
vs.	)	
THANE INTERNATIONAL, INC., WILLIAM F. HAY, DENISE DUBARRY-HAY, KEVIN MCKEON and MARK TAYLOR,	)	
Defendants.	)	

EXHIBIT 44

* * *

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VIA COURIER

June 1, 2004

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Re: *Thane International, Inc. Securities Litigation,*
USDC C.D. Cal. Case No. SA CV 03-1031 JVS (SGLx)

Dear Counsel:

Enclosed please find the defendants' expert's report. If you have any questions regarding the foregoing please call me at the number above.

Sincerely,

/s/ Christopher B. McDavid
Christopher B. McDavid

cc: Lionel Z. Glancy, Esq.

THANE INTERNATIONAL

Securities Litigation

Expert Report of Bradford Cornell, Ph.D.

(Defendants' Expert)

Expert Report of Bradford Cornell – Thane

Background and Qualifications

(1) I am a Professor of Finance and Director of the Bank of America Research Center at the Anderson Graduate School of Management at the University of California, Los Angeles (UCLA) and a Senior Consultant to Charles River Associates. I earned a M.S. degree in Statistics from Stanford University in 1974 and earned my Ph.D. degree in Financial Economics also from Stanford University in 1975.

(2) Since 1975, I have taught a variety of courses, including courses involving corporate valuation, the law and finance of corporate acquisitions and restructuring, corporate financial theory, and securities valuation and investments. I have also taught at the UCLA Law School. At UCLA, I have twice served as Vice-Chairman of the Anderson School and have twice served as Chairman of the Finance Department. Aside from my teaching responsibilities, I have been active in research. I have written more than 70 articles and two books on finance and securities including *Corporate Valuation: Tools for Effective Appraisal and Decision-Making,*

published by McGraw-Hill, and *The Equity Risk Premium and the Long-Run Future of the Stock Market,* published by John Wiley. To complement my academic writing, I have also authored articles for *The Wall Street Journal* and the *Los Angeles Times.*

(3) My research has been widely recognized. In 1988, I was cited by the Financial Management Association as one of the ten most prolific authors in the field of finance. I have also received prizes and grants for my research from the Chicago Board of Trade, the Chicago Mercantile Exchange and the Institute for Quantitative Research in Finance. My article, "Corporate Stakeholders and Corporate Finance," for which my co-author, Alan C. Shapiro, and I received the 1987 Distinguished Applied Research Award from the Financial Management Association, is the most frequently cited article published in Financial Management since 1985. In 1999, I was awarded the I/B/E/S prize for empirical work in finance and accounting (with Wayne Landsman and Jennifer Conrad.)

(4) I have consulted and/or provided expert testimony in over 14 matters involving allegations of securities fraud on behalf of both plaintiffs and defendants, including: *DeLaurentiis Entertainment Group Class Action, In re Hamburger Hamlet Securities Litigation, In re National Medical Enterprises Securities Litigation, Brogren v. Pohlad, Coram v. Caremark, Mittman et al v. Rally's Hamburgers, Inc., In re Assisted Living Concepts,*

Inc., *In re Envoy Corp. Securities Litigation*, and *Estate of Peregrine Systems, Inc.*

(5) I have also been active in my profession. I am a past Vice-President of the Western Finance Association. I am also a past director of both the American Finance Association and the Western Finance Association. I have served as an associate editor of numerous professional journals including: *The Journal of Finance, The Journal of Futures Markets, The Journal of Financial Research* and *The Journal of International Business Studies.* I have served as a reviewer for nearly a dozen other professional journals. I am currently a member of the Pension Policy Board of the Aerospace Corporation.

My background is described more fully in my curriculum vitae, which is attached hereto as Exhibit 1. A list of my publications over the last ten years is also included as part of Exhibit 1. A list of my deposition and trial testimony over the last four years is attached as Exhibit 2. I am being compensated for my work on this matter at a rate of $600 per hour. Other members of my staff are being compensated for their time at rates ranging from $95 per hour to $465 per hour. A list of documents that I have considered in preparing this report is attached as Exhibit 3.

Opinions and Basis for Opinions

Counsel for Defendant Thane International, Inc. ("Thane") has asked me to perform the following tasks:

- Calculate damages (if any) suffered by Thane's shareholders between May 24, 2002 and September 23, 2002 as a result of Thane's purported "failure" to list upon the NASDAQ National Market System ("NMS") when Section 12(a)(2) and Section 12(b) of the Securities Act of 1933 are taken into account; and,
- Calculate theoretical maximum economic harm that could potentially have been suffered by Thane's shareholders between May 24, 2002 and September 23, 2002 as a result of Thane's purported "failure" to list upon the NMS, irrespective of any legal considerations.

For purposes of my analyses contained in this report, Thane's counsel has asked me to assume that there was a misstatement or omission in Thane's prospectus concerning listing on the NMS, and that Thane is only liable for damages to shareholders caused by material misstatements or omissions. It is not liable for economic losses suffered by its shareholders due to other causes, I reserve the right to amend and supplement my opinions as new information becomes available.

Section 12(a)(2) Damages

For purposes of my first analysis pursuant to Section 12(a)(2) of the Securities Act of 1933, Thane's counsel has asked that I assume the following:

- Thane shareholders are only eligible for damages arising from material misstatements or omissions in Thane's prospectus if Thane's trading price per share is below Thane's imputed merger price within a reasonable time after the nature of the misstatement or omission in Thane's prospectus became known to the market;

- Thane's imputed merger price is calculated by using the exchange ratio of Reliant Interactive Media Corp. ("Reliant") shares to Thane shares described in Thane's prospectus and multiplying this ratio by Reliant's closing price immediately prior to its merger with Thane;

According to Thane's prospectus, the exchange ratio of Thane shares to Reliant shares pursuant to the merger of the two companies was 0.3049459 Thane shares for each Reliant share.[1] As of the market's close on May 23, 2002 (the last trading day for Reliant stock before the merger with Thane was completed), Reliant's closing price was $2.10 per share.[2] Thus, each Thane share had an imputed

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[1] Thane International, Inc. Proxy Statement/Prospectus dated April 25, 2002.

[2] Source: Interactive Data Corp.

merger price of $6.89 per share. Supporting calculations may be found as Exhibit 4. Consequently, Thane's shareholders are only eligible for damages under Section 12(a)(2) of the Securities Act of 1933 if Thane's trading price drops below $6.89 per share within a reasonable time after it became known to the market that Thane had not listed on the NMS.

I have reviewed plaintiff's deposition in the course of preparing this report. It is my observation that plaintiff seeks to create the impression that there is a substantial difference in the cost and ease of trading stock on the NASDAQ NMS versus the Over the Counter Bulletin Board. In reality, the NASDAQ oversees both the NMS and the Bulletin Board. Both markets are negotiated markets[3] that are widely available to retail brokers through the NASDAQ electronic real-time quotation system. Although the NMS has more stringent listing requirements than the Bulletin Board in terms of market capitalization, number of market makers, and number of shareholders, real-time electronic quotes on all Bulletin Board stocks are available to all NASDAQ Workstation II subscribers (retail brokers and market makers), just as they are with NMS stocks. Further, all companies that trade on the Bulletin Board must comply with the reporting requirements of either the SEC or the applicable

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[3] Buyers and sellers negotiate directly with intermediaries, known as market makers, who ensure liquidity by purchasing shares from sellers and selling shares to buyers.

banking or insurance regulators.[4] The widespread availability of real-time quotes on Bulletin Board stocks give the Bulletin Board transparency, accessibility, and relative liquidity. Accordingly, in the abstract, one would expect that the price differential between trading on the Bulletin Board versus the NMS would be modest at worst. Put another way, the NMS and the Bulletin Board are two electronic forums where buyers meet sellers through broker-dealer intermediaries, and while one has greater liquidity, the hypothetical difference in price for stocks trading on one electronic forum versus another would be very modest compared to what principally drives a company's price, namely its fundamentals and the general market's performance.

Here, Thane opened its first day of public trading after the merger on May 24, 2002 at $7.00 per share, which was its low for the day. At that time, current and potential investors were instantaneously aware that Thane had not been listed on the NMS but instead traded on the Bulletin Board. In fact, plaintiff Howard Miller posted e-mail in an Internet chat room on May 25, 2002 stating that he had been told that Thane would trade on the Bulletin Board for a while, thus helping to further disseminate this information.[5] Thane's stock did not trade below $6.89 per share at any time until June 12, 2002, nineteen days later.

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[4] Materials downloaded from *www.sec.gov* and www.otcbb.com.

[5] Exhibit 7 to Deposition of Howard Miller.

Throughout this period, Thane's stock continued to trade on the Bulletin Board, a fact that was known to the market because it was readily ascertainable from the NASDAQ electronic quote system used by the OTC Bulletin Board.

Thane stock was very thinly traded and no analysts covered it between May 24 and September 23, 2002. Nonetheless, it was known at all times to the market that Thane was trading on the OTC Bulletin Board. Any current or potential investor (and his or her broker) was made aware of the market in which Thane stock traded by the NASDAQ's Workstation II electronic quotation system. As plaintiff himself has testified, "Any idiot can look at the [electronic quotation] screen and see where's the market."[6] Consequently, the market was fully aware of the fact that Thane was not listed on the NMS from the time of its initial listing through and including the day it dropped below the imputed merger price (June 11, 2002). Because Thane stock always traded above its imputed merger price of $6.89 per share between May 24 and June 11, 2002 after the market was aware (and was made further aware by plaintiff) that Thane had not listed on the NMS, Thane's shareholders could not have been damaged by Thane's failure to list on the NMS under Section 12(a)(2) of the Securities Act of 1933. Any decline in the price of Thane's stock subsequent to June 11, 2002 had to be caused

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[6] Miller Dep. at p. 60, ln 19-21.

by factors other than where it was listed (i.e., Bulletin Board versus NMS).

To further analyze possible causes for Thane's stock price decline below its imputed merger value of $6.89 per share after June 11, 2002, I have performed an event study analysis of Thane from May 24, 2002 (when it was first publicly traded) through September 23, 2002 (the date plaintiffs filed their complaint). An event study analysis examines a company's stock price behavior (often relative to a market or industry index) in response to news disclosures such as earnings announcements and the release of analyst reports, if any.

To take market and industry conditions into account, I created a market value-weighted index of five comparable companies: Helen of Troy Ltd. (formerly Helen of Troy Corp.), Nautilus Group, Inc. (formerly Direct Focus, Inc.), Cross Media Marketing Corp. (formerly Symposium Corp.), Valuevision Media, Inc. (formerly Valuevision International, Inc.), and Concepts Direct, Inc. I selected these companies based on a number of factors, including: 1) companies that had the same Standard Industrial Classification (SIC) code, Bloomberg Industry Group, and Bloomberg Industry Subgroup as Thane; 2) a review of the testimony to date; and 3) discussions with Thane's principals. Thane's SIC code was listed as 5961 – Catalog and Mail-Order Houses.[7] Thane's Bloomberg

[7] Sources: Bloomberg and *www.osha.gov*.

Industry Group was Advertising and its Industry Subgroup was Direct Marketing.[8]

I compared Thane's and the comparable index performance to the NASDAQ Composite Index between May 24, 2002 and September 23, 2002. Both Thane and the value-weighted index of its competitors underperformed the NASDAQ Composite Index, which declined by over 28% during the period. The value-weighted index of Thane's competitors declined by approximately 39% over the period, and Thane itself declined by almost 78% over the period. A chart showing Thane's performance relative to the comparable index and the NASDAQ composite may be found as Exhibit 5. In performing my event study, I analyzed all publicly available news items available on Factiva and Bloomberg but only included the first instance of a particular news item. I also examined the items contained in Howard Miller's Deposition Exhibits 7 and 10 to take into account possible leakages of information associated with postings in a Thane-related Internet chat room but did not include these items in my event study. My event study may be found as Exhibit 6.

My event study analysis confirms that Thane's stock traded above its merger value of $6.89 per share for a nineteen-day period after it came on the

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[8] Source: Bloomberg. Provell, Inc was also listed as a comparable company but trading data were not available during the relevant period.

market and that its subsequent decline below this value was not related to its trading on the Bulletin Board as opposed to the NMS because Thane stock traded on the Bulletin Board throughout the analysis period. The substantial declines in the NASDAQ Composite Index (by over one-fourth of its value) and the peer group index (by well over one-third of its value) show that market and industry conditions account for a considerable portion of Thane's stock price decline. Further, Thane's adverse sales and earnings announcement on August 14, 2002 accounts for still more of Thane's stock price decline over the period. The August 14, 2002 earnings announcement disclosed that Thane's GAAP earnings for the quarter ended June 30, 2002 were $0.07 per share as opposed to $0.13 per share for the same quarter ended June 30, 2001[9]. Over a three trading day period, Thane's stock declines from $3.60 per share on August 13, 2002 to $1.95 per share on August 16, 2002, a decline of approximately 46%. Thus, Thane's shares declined in proportion to its adverse earnings announcement. Nothing in my event study (and analysis of the Internet chat room postings) indicated that Thane's trading on the Bulletin Board as opposed to the NMS caused Thane's stock price to trade below $6.89, its imputed merger value. Consequently, Thane

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[9] Thane's earnings announcement was even worse on a *pro forma* basis (without taking into account accelerated amortization on various items). Thane's *pro forma* earnings for the quarter ended June 30, 2002 were $0.05 per share compared to $0.16 per share for the quarter ended June 30, 2001.

shareholders suffered no damages under Section 12(a)(2) of the Securities Act of 1933.

Maximum Theoretical Economic Harm (Ignoring the Market's Actual Reaction)

Thane's counsel has requested that I calculate the maximum theoretical economic harm to Thane's shareholders as a result of Thane's failure to list on the NMS. Under this scenario, I ignored the market's actual response to the fact that Thane traded on the Bulletin Board (as opposed to the NMS), which as stated above, yielded a conclusion of zero damages. For purposes of this analysis, Thane's counsel has asked me to assume that Thane non-insider shareholders who received their stock pursuant to the merger with Reliant and sold their shares at a price equal to or greater than Thane's imputed merger price of $6.89 per share are not eligible for damages. As mentioned above, I limit my measure of economic harm suffered by Thane's shareholders to that actually caused by Thane's failure to list on the NMS and exclude harm due to other causes.

Economic Harm Caused by Lost Liquidity

A stock's liquidity refers to the cost and ease with which it can be sold.[10] In formulating my opinions, I

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[10] *See* Zvi Bodie, Alex Kane, and Alan J. Marcus, "Investments," Fifth Ed., McGraw-Hill-Irwin: 2002, p. 279.

have considered the work of Amihud and Mendelson (1989), in which they posit that the expected impact of reduced liquidity on a security's value can be measured by the present value of the incremental transactions costs brought about by the reduced liquidity to all shareholders who ever trade the security into perpetuity. Inherent in this model is the assumption that reduced liquidity results in higher incremental transactions costs, i.e., bid-ask spreads.[11] This approach to measuring economic harm takes into account any higher spreads that could potentially result from having a small public float and no analyst coverage.

In implementing Amihud and Mendelson's model, I examined the effect of a change in annual transactions costs (as measured by bid-ask spread multiplied by annual turnover) upon the stock of a hypothetical company whose entire cash flow per share consisted

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[11] The bid-ask spread for a stock, particularly one traded in a negotiated market like the NASDAQ or the OTC Bulletin Board, is the difference between the price at which a market maker is willing to purchase the stock from an investor who wishes to sell the stock (bid price) and the price at which the market maker is willing to sell the stock to an investor who wishes to purchase the stock (ask price). This spread represents the amount of profit earned by the market maker on a round-trip transaction in a security (purchase and sale). A wider bid-ask spread relative to a stock's price indicates a less liquid stock because it costs more to purchase and sell the stock, thus providing both current and potential investors with a disincentive to change the status quo and either sell or purchase the stock.

of a $1 dividend received each year into perpetuity. (This is just a way of establishing a baseline, so that one can compare only the effects of trading on the Bulletin Board as opposed to trading on the NMS.) The value of this company's stock is its cash flow per share divided by its cost of equity capital. A company's cost of equity capital is the annual return on the company's stock that is expected by its shareholders over time to compensate them for the time value of their money and the non-diversifiable risks involved in holding the company's stock.

Here, I have assumed that this hypothetical company's cost of equity capital is equal to Thane's cost of equity capital at the time of its merger with Reliant and subsequent share exchange. I use a technique that is well known in theoretical finance for estimating Thane's cost of equity capital known as the Capital Asset Pricing Model (CAPM). The key assumptions behind the CAPM are as follows:

- Investors are naturally risk-averse, i.e., they expect to be compensated for bearing additional risk, which is defined as variability of future returns;
- Investors can earn the risk-free rate on risk-less assets, i.e., government securities.
- All firm-specific risk (unsystematic risk) can be diversified away by holding stocks in the context of a group, or portfolio, and the fact that these stocks do not move in perfect tandem with each other, i.e., are not perfectly positively correlated, helps to smooth out

price fluctuations in individual stocks over time and reduce the risk, or variability of future price returns, to the shareholder;

- Beta is a measure of a stock's movement in relation to that of the market as a whole;
- The market consists of all risky assets available to investors and is assumed to move in perfect tandem with itself, i.e., its beta is one;
- Because the market consists of all risky assets, investors investing in the market portfolio demand a higher return than if they were investing in risk-free assets. In other words, they demand a *risk premium* in order for investing in the market portfolio to be attractive to them;

Exhibit 7 shows my calculation of Thane's cost of equity capital as of the time of its merger with Reliant. I calculate Thane's forward-looking cost of equity capital to be 12.83%. In calculating this number, I began with the average monthly 20-Year constant maturity Treasury bond rate of 5.81% as my proxy for the risk-free rate. I multiplied my estimate of the long-term forward-looking equity risk premium for the market as a whole of 5.50%[12] by Thane's

[12] My estimate of the long-term forward-looking equity risk premium is a conservative (i.e., high) estimate that, if anything, favors plaintiffs. For example, in a 2001 article, Professor Ivo Welch of Yale surveyed 510 finance and economics professors and found that the consensus forecast for the 30-year arithmetic equity premium was about 5 to 5.5%. (Ivo Welch, "The Equity

(Continued on following page)

forward-looking BARRA beta of 1.28 and added this adjusted risk premium to my 5.81% risk-free rate estimate to arrive at 12.83%.

Returning to my model, if the hypothetical company's stock could be traded without incurring transaction costs, its value per share to shareholders would be $7.79, or the present value of the $1 dividend into perpetuity when it is divided by the company's 12.83% cost of equity capital. This calculation can be found in Exhibits 8 and 9, which detail the calculations of the diminution in value to this hypothetical stock caused by transactions costs involved in trading it, depending upon whether it is assumed to trade on the OTC Bulletin Board or the NASDAQ NMS. In Exhibit 8, I assume that the hypothetical company trades on the OTC Bulletin Board and that its bid-ask spread is 11%.

I derived this spread by examining real-time intra-day data for Thane on June 5, 2002 (the first trading day for which such data are available) and finding that its average bid-ask spread as a

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Premium Consensus Forecast Revisited", September 8, 2001). In 2001, Professors J.R. Graham and Campbell Harvey did a survey of corporate chief financial officers and found their 10-year risk premium estimates to range between 3.6% and 4.7%. (J.R. Graham and Campbell R. Harvey, "Expectations of Equity Risk Premia, Volatility and Asymmetry from a Corporate Finance Perspective," Working Paper, October 9, 2001).

percentage of the bid price was approximately 11%.[13] I used Thane's bid price as the denominator because it represents the price at which a Thane shareholder who received stock in the exchange offer would have been able to sell those shares to a market maker in order to dispose of his or her holdings. I used the earliest possible trade date because I wanted to get a measure of Thane's bid-ask spread using intra-day data as soon as possible after it started trading in the public market.

In Exhibit 8, I also used Thane's annual turnover as a measure of the hypothetical company's annual turnover if it had traded on the OTC Bulletin Board. I determined that Thane's actual annual turnover was 0.70838 in its first year of trading. I calculated this number by looking at Thane's actual annual trading volume from May 24, 2002 through May 23, 2003 and dividing it by Thane's public float. Supporting calculations may be found as Exhibit 10.

In order to calculate present value of transactions costs into perpetuity for trading this hypothetical company, I calculated its annual transactions costs by multiplying its bid-ask spread by its annual turnover. I then took the annual transactions costs for 66 years to simulate perpetuity and discounted these annual amounts to the present value and used

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[13] I confirmed this result by computing the average real-time spread for Thane between June 5 and June 28, 2002. Thane's average real-time spread during June 2002 was 11.03%.

Thane's cost of equity capital of 12.83% as the discount rate. This hypothetical company in Exhibit 8 is therefore assumed to trade on the OTC Bulletin Board with a bid-ask spread and annual turnover equal to that of Thane. Consequently, its stock would trade at a discount of 37.80% from its frictionless value of $7.79 per share, or at $4.85 per share with transactions costs.

In Exhibit 9, I assumed that this hypothetical company was listed for trading on the NASDAQ NMS. Consequently, I expected that such a company would have lower incremental transactions costs, i.e., a lower-bid-ask spread, and a higher annual turnover rate. Here, I researched the financial literature and found that a study by Chan, Christie, and Schultz (1995) had the lowest inside spread (highest bid, lowest ask) of $0.16 for a sample of 18 stocks. The minimum stock price in this sample was $3.69 per share. I used this $0.16 spread as a percentage of the $7.79 frictionless value that I computed in my model and arrived at 2.05%.

Given the low initial price per share and small public float of Thane's stock, I felt that my estimate of Thane's hypothetical bid-ask spread had it been listed on the NASDAQ NMS was very conservative. I then found that the turnover for stocks listed on the NASDAQ stock market as a whole was 2.94 times per

year in 2001[14], the last full year for which data were available before Thane's stock traded. I estimated the annual transactions costs for the hypothetical company in Exhibit 9 by multiplying its hypothetical NMS bid-ask spread by its annual hypothetical NASDAQ turnover. I then discounted these annual transactions costs for 66 years (to simulate perpetuity) back to the present value at Thane's cost of equity of 12.83%. I thus found that the net effect on this hypothetical company's frictionless value of trading on the NASDAQ NMS was 32.00%.

I then applied the discounts calculated in Exhibits 8 and 9 to Thane's imputed merger price of $6.89, which is the value of what Reliant shareholders gave up in the exchange. I estimate that listing on the NASDAQ NMS as opposed to the OTC Bulletin Board would have added no more than $0.40 in value per share to Thane's stock price. Supporting calculations may be found as Exhibit 11.

My final step in my analysis was to apply this $0.40 per share amount to real-time intraday trading data for Thane from May 24, 2002 through September 23, 2002, the date that plaintiffs filed their complaint in this action to determine how many Thane shares potentially could have been harmed by Thane's failure to list on the NMS. I assumed that

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[14] Source: Frank Gretz's Equities Perspective, May 17, 2002. Mr. Gretz is Chief Technical Analyst with Shields & Company, a brokerage firm based in New York City.

1,318,306 shares were eligible for damages. Supporting calculations may be found as Exhibit 12. I reduced the amount of Thane shares eligible for damages on a daily basis by the tick-by-tick trading volume over the period May 24, 2002 through September 23, 2002 and only counted as potentially harmed those shares that traded at prices below $6.89 per share (Thane's imputed merger price). I limited the maximum economic harm per share to $0.40 because this was the maximum theoretical economic harm per share that Thane's shareholders theoretically could have suffered as a result of Thane's trading on the Bulletin Board as opposed to the NMS. If the difference between the actual trading price and Thane's imputed merger price was less than $0.40, I used that difference as the measure of maximum theoretical economic for the shares involved in that trade. I then multiplied the remaining Thane shares eligible for damages that did not trade between May 24 and September 23, 2002 by the maximum theoretical economic harm per share of $0.40 to calculate the maximum possible economic harm for Thane shares that were held through September 23, 2002. I calculated that the maximum possible economic harm to Thane shareholders due to Thane's failure to list on the NMS was $500,066. Supporting calculations may be found as Exhibit 13.

Conclusions

Thane's trading price remained above the imputed merger price for over two and one-half weeks

after it began to trade publicly and the fact that it traded on the Bulletin Board was widely known to the market from the very beginning. Despite the market's knowledge about where a market for Thane's stock was being made (i.e., Bulletin Board as opposed to NMS), Thane's stock traded above the imputed merger price for nearly three weeks after the merger, meaning that Thane's subsequent decline had to have been caused by factors other than where it traded. Further, my event study analysis of Thane from May 24 through September 23, 2002 shows that Thane's price decline to levels below its imputed merger price was not caused by its trading on the Bulletin Board as opposed to the NASDAQ NMS. Rather, this decline can be accounted for to a considerable degree by prevailing market and industry conditions and by an adverse sales and earnings announcement by Thane itself. Consequently, Thane's shareholders were not damaged under Section 12(a)(2) of the Securities Act of 1933.

Even if one ignores Section 12(a)(2) and focuses on maximum theoretical economic harm due to lost liquidity, the maximum amount by which Thane shareholders could have been harmed by Thane's failure to list on the NASDAQ NMS is $500,066.

/s/ Bradford Cornell Date: 6/1/2004
Bradford Cornell

EXHIBIT 13

Thane International, Inc.
Hypothetical Loss Causation Analysis

Date	Time	Volume	Price	Code	Imputed Merger Price	Total Economic Harm	Maximum Per Share Economic Harm	Cumulative Volume	Eligible Shares
5/24/2002		1,800	$7.000	Daily Low	$6.89	$0	$0.00	1,800	1,316,306
5/28/2002		2,300	$7.300	Daily Low	$6.89	$0	$0.00	4,100	1,314,006
5/29/2002		1,200	$8.000	Daily Low	$6.89	$0	$0.00	5,300	1,312,806
5/30/2002		6,000	$7.250	Daily Low	$6.89	$0	$0.00	11,300	1,306,806
5/31/2002		4,200	$7.250	Daily Low	$6.89	$0	$0.00	15,500	1,302,606
6/3/2002		1,700	$7.750	Daily Low	$6.89	$0	$0.00	17,200	1,300,906
6/4/2002		5,700	$7.500	Daily Low	$6.89	$0	$0.00	22,900	1,295,206
6/5/2002	9:32:00 AM	300	$7.250		$6.89	$0	$0.00	23,200	1,294,906
6/5/2002	9:32:01 AM	300	$7.250		$6.89	$0	$0.00	23,500	1,294,606
6/5/2002	9:36:23 AM	300	$7.250		$6.89	$0	$0.00	23,800	1,294,306
6/5/2002	9:36:26 AM	300	$7.250		$6.89	$0	$0.00	24,100	1,294,006
6/5/2002	9:37:15 AM	300	$7.250		$6.89	$0	$0.00	24,400	1,293,706
6/5/2002	9:37:29 AM	300	$7.250		$6.89	$0	$0.00	24,700	1,293,406
6/5/2002	1:45:24 PM	5,000	$7.750		$6.89	$0	$0.00	29,700	1,288,406
6/5/2002	1:51:29 PM	4,100	$7.750		$6.89	$0	$0.00	33,800	1,284,306
6/5/2002	2:04:45 PM	300	$7.500		$6.89	$0	$0.00	34,100	1,284,006
6/5/2002	2:05:02 PM	300	$7.500	SLD	$6.89	$0	$0.00	34,400	1,283,706
6/6/2002	13:18:06	4,200	$7.500		$6.89	$0	$0.00	38,600	1,279,506
6/6/2002	14:08:43	300	$7.500		$6.89	$0	$0.00	38,900	1,279,206
6/7/2002	10:23:45	100	$7.500		$6.89	$0	$0.00	39,000	1,279,106
6/7/2002	11:55:57	1,000	$7.500		$6.89	$0	$0.00	40,000	1,278,106
6/7/2002	11:57:02	500	$7.500		$6.89	$0	$0.00	40,500	1,277,606
6/7/2002	13:43:23	8,600	$7.900		$6.89	$0	$0.00	49,100	1,269,006
6/10/2002	10:24:05	300	$7.900		$6.89	$0	$0.00	49,400	1,268,706
6/10/2002	11:29:58	500	$7.750		$6.89	$0	$0.00	49,900	1,268,206
6/10/2002	11:30:07	500	$7.500		$6.89	$0	$0.00	50,400	1,267,706
6/10/2002	11:45:33	300	$7.000		$6.89	$0	$0.00	50,700	1,267,406
6/10/2002	13:18:42	400	$7.000		$6.89	$0	$0.00	51,100	1,267,006
6/10/2002	14:02:11	500	$7.500		$6.89	$0	$0.00	51,600	1,266,506

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6/10/2002	14:02:19	500	$7.300	$6.89	$0	$0.00	52,100	1,266,006
6/10/2002	14:21:40	2,900	$7.000	$6.89	$0	$0.00	55,000	1,263,106
6/10/2002	14:21:45	2,100	$7.300	$6.89	$0	$0.00	57,100	1,261,006
6/10/2002	15:26:02	100	$7.000	$6.89	$0	$0.00	57,200	1,260,906
6/11/2002	9:44:51	2,300	$7.050	$6.89	$0	$0.00	59,500	1,258,606
6/12/2002	15:16:19	500	$7.000	$6.89	$0	$0.00	60,000	1,258,106
6/12/2002	15:16:40	500	$7.000	$6.89	$0	$0.00	60,500	1,257,606
6/12/2002	15:17:12	500	$7.000	$6.89	$0	$0.00	61,000	1,257,106
6/12/2002	15:40:37	400	$6.500	$6.89	$156	$0.39	61,400	1,256,706
6/12/2002	15:45:27	500	$6.750	$6.89	$70	$0.14	61,900	1,256,206
6/12/2002	15:45:34	500	$6.620	$6.89	$135	$0.27	62,400	1,255,706
6/13/2002	11:52:38	3,000	$6.750	$6.89	$420	$0.14	65,400	1,252,706
6/14/2002	9:30:02	3,000	$7.150	$6.89	$0	$0.00	68,400	1,249,706
6/14/2002	11:46:15	200	$7.150	$6.89	$0	$0.00	68,600	1,249,506
6/14/2002	12:55:30	400	$7.000	$6.89	$0	$0.00	69,000	1,249,106
6/18/2002	14:24:12	500	$6.500	$6.89	$195	$0.39	69,500	1,248,606
6/18/2002	14:49:04	1,200	$6.400	$6.89	$480	$0.40	70,700	1,247,406
6/18/2002	14:49:30	700	$6.300	$6.89	$280	$0.40	71,400	1,246,706
6/18/2002	14:50:04	1,200	$6.750	$6.89	$168	$0.14	72,600	1,245,506
6/18/2002	14:53:30	500	$6.400	$6.89	$200	$0.40	73,100	1,245,006
6/19/2002	14:10:36	500	$6.450	$6.89	$200	$0.40	73,600	1,244,506
6/19/2002	14:10:39	500	$6.500	$6.89	$195	$0.39	74,100	1,244,006
6/19/2002	14:50:27	400	$6.300	$6.89	$160	$0.40	74,500	1,243,606
6/20/2002	9:30:07	1,000	$6.500	$6.89	$390	$0.39	75,500	1,242,606
6/20/2002	9:37:07	1,500	$6.500	$6.89	$585	$0.39	77,000	1,241,106
6/20/2002	10:12:13	1,000	$6.500	$6.89	$390	$0.39	78,000	1,240,106
6/24/2002	12:00:24	500	$6.250	$6.89	$200	$0.40	78,500	1,239,606
6/24/2002	12:01:21	500	$6.250	$6.89	$200	$0.40	79,000	1,239,106
6/24/2002	12:02:00	500	$6.000	$6.89	$200	$0.40	79,500	1,238,606
6/25/2002	9:45:20	500	$5.750	$6.89	$200	$0.40	80,000	1,238,106
6/25/2002	13:39:01	500	$5.750	$6.89	$200	$0.40	80,500	1,237,606
6/25/2002	13:45:08	1,000	$6.000	$6.89	$400	$0.40	81,500	1,236,606
6/25/2002	13:45:08	1,000	$5.760	$6.89	$400	$0.40	82,500	1,235,606
6/25/2002	13:46:53	500	$5.750	$6.89	$200	$0.40	83,000	1,235,106
6/25/2002	13:47:45	500	$5.500	$6.89	$200	$0.40	83,500	1,235,606
6/25/2002	13:48:16	500	$5.500	$6.89	$200	$0.40	84,000	1,234,106
6/25/2002	13:48:45	500	$5.500	$6.89	$200	$0.40	84,500	1,233,606

6/25/2002	13:49:13	500	$5.250		$6.89	$200	$0.40	85,000	1,233,106
6/25/2002	13:49:21	2,400	$5.500		$6.89	$960	$0.40	87,400	1,230,706
6/25/2002	14:38:38	500	$5.400		$6.89	$200	$0.40	87,900	1,230,206
6/25/2002	14:39:15	500	$5.400		$6.89	$200	$0.40	88,400	1,229,706
6/25/2002	14:40:25	500	$5.400		$6.89	$200	$0.40	88,900	1,229,206
6/25/2002	14:40:55	500	$5.400		$6.89	$200	$0.40	89,400	1,228,706
6/25/2002	15:14:30	700	$5.200		$6.89	$280	$0.40	90,100	1,228,006
6/25/2002	15:14:30	700	$5.250		$6.89	$280	$0.40	90,800	1,227,306
6/26/2002	10:29:46	100	$5.100		$6.89	$40	$0.40	90,900	1,227,206
6/26/2002	11:04:35	500	$5.100		$6.89	$200	$0.40	91,400	1,226,706
6/26/2002	11:04:37	500	$5.100		$6.89	$200	$0.40	91,900	1,226,206
6/26/2002	11:06:16	500	$5.100		$6.89	$200	$0.40	92,400	1,225,706
6/26/2002	11:59:05	2,200	$5.000		$6.89	$880	$0.40	94,600	1,223,506
6/26/2002	12:04:15	2,200	$5.050		$6.89	$880	$0.40	96,800	1,221,306
6/26/2002	12:29:55	300	$5.000		$6.89	$120	$0.40	97,100	1,221,006
6/26/2002	13:46:16	200	$5.000		$6.89	$80	$0.40	97,300	1,220,806
6/26/2002	14:12:15	500	$5.000		$6.89	$200	$0.40	97,800	1,220,306
6/28/2002	10:10:44	500	$4.900		$6.89	$200	$0.40	98,300	1,219,806
6/28/2002	10:25:24	100	$5.100		$6.89	$40	$0.40	98,400	1,219,706
6/28/2002	10:37:37	2,000	$5.100		$6.89	$800	$0.40	100,400	1,217,706
6/28/2002	12:12:59	1,000	$4.800		$6.89	$400	$0.40	101,400	1,216,706
7/1/2002	9:51:09	500	$4.700		$6.89	$200	$0.40	101,900	1,216,206
7/1/2002	14:36:49	1,000	$4.500		$6.89	$400	$0.40	102,900	1,215,206
7/2/2002	9:30:34	600	$4.500		$6.89	$240	$0.40	103,500	1,214,606
7/2/2002	11:49:41	500	$4.500		$6.89	$200	$0.40	104,000	1,214,106
7/2/2002	11:51:03	500	$4.500		$6.89	$200	$0.40	104,500	1,213,606
7/2/2002	11:51:10	500	$4.500		$6.89	$200	$0.40	105,000	1,213,106
7/2/2002	11:51:31	500	$4.350		$6.89	$200	$0.40	105,500	1,212,606
7/2/2002	14:45:22	500	$4.500		$6.89	$200	$0.40	106,000	1,212,106
7/2/2002	16:09:53	500	$4.500	T	$6.89	$200	$0.40	106,500	1,211,606
7/8/2002	9:44:19	2,500	$4.500		$6.89	$1,000	$0.40	109,000	1,209,106
7/8/2002	15:17:28	500	$4.380		$6.89	$200	$0.40	109,500	1,208,606
7/8/2002	15:17:31	500	$4.380		$6.89	$200	$0.40	110,000	1,208,106
7/8/2002	15:59:32	500	$4.370		$6.89	$200	$0.40	110,500	1,207,606
7/8/2002	15:59:42	500	$4.370		$6.89	$200	$0.40	111,000	1,207,106
7/9/2002	11:15:14	500	$4.250		$6.89	$200	$0.40	111,500	1,206,606
7/9/2002	13:59:49	100	$4.250		$6.89	$40	$0.40	111,600	1,206,506

7/9/2002	15:04:00	200	$4.250		$6.89	$80	$0.40	111,800	1,206,306
7/11/2002	10:10:23	100	$4.500		$6.89	$40	$0.40	111,900	1,206,206
7/11/2002	10:33:02	600	$4.200		$6.89	$240	$0.40	112,500	1,205,606
7/11/2002	10:57:09	100	$4.200		$6.89	$40	$0.40	112,600	1,205,506
7/11/2005	14:14:25	400	$4.200		$6.89	$160	$0.40	113,000	1,205,106
7/11/2002	14:15:14	500	$4.200		$6.89	$200	$0.40	113,500	1,204,606
7/12/2002	9:30:25	200	$4.250		$6.89	$80	$0.40	113,700	1,204,406
7/12/2002	9:34:28	500	$4.000		$6.89	$200	$0.40	114,200	1,203,906
7/12/2002	9:36:08	500	$4.000		$6.89	$200	$0.40	114,700	1,203,406
7/12/2002	9:36:50	500	$4.000		$6.89	$200	$0.40	115,200	1,202,906
7/12/2002	9:43:56	500	$4.000		$6.89	$200	$0.40	115,700	1,202,406
7/12/2002	10:28:45	200	$3.990	SLD	$6.89	$80	$0.40	115,900	1,202,206
7/12/2002	15:50:13	300	$4.000		$6.89	$120	$0.40	116,200	1,201,906
7/15/2002	9:58:12	500	$4.050		$6.89	$200	$0.40	116,700	1,201,406
7/15/2002	9:59:33	700	$4.000		$6.89	$280	$0.40	117,400	1,200,706
7/15/2002	10:00:01	500	$4.000		$6.89	$200	$0.40	117,900	1,200,206
7/15/2002	10:00:59	700	$4.050		$6.89	$280	$0.40	118,600	1,199,506
7/15/2002	10:02:47	500	$4.050		$6.89	$200	$0.40	119,100	1,199,006
7/15/2002	10:04:01	500	$4.100		$6.89	$200	$0.40	119,600	1,198,506
7/15/2002	10:05:51	500	$4.100		$6.89	$200	$0.40	120,100	1,198,006
7/15/2002	10:07:50	500	$4.100		$6.89	$200	$0.40	120,600	1,197,506
7/15/2002	10:25:49	1,000	$4.000		$6.89	$400	$0.40	121,600	1,196,506
7/15/2002	10:27:17	800	$4.000		$6.89	$320	$0.40	122,400	1,195,706
7/15/2002	10:55:11	500	$4.100		$6.89	$200	$0.40	122,900	1,195,206
7/15/2002	10:56:59	1,000	$4.100		$6.89	$400	$0.40	123,900	1,194,206
7/15/2002	14:56:18	500	$3.800		$6.89	$200	$0.40	124,400	1,193,706
7/15/2002	14:58:09	500	$3.800		$6.89	$200	$0.40	124,900	1,193,206
7/15/2002	14:59:31	500	$3.750		$6.89	$200	$0.40	125,400	1,192,706
7/15/2002	14:59:52	500	$3.750		$6.89	$200	$0.40	125,900	1,192,206
7/17/2002	15:22:14	300	$3.750		$6.89	$120	$0.40	126,200	1,191,906
7/18/2002	9:30:13	300	$3.600		$6.89	$120	$0.40	126,500	1,191,606
7/18/2002	12:25:58	100	$3.600		$6.89	$40	$0.40	126,600	1,191,506
7/18/2002	12:47:04	200	$3.600		$6.89	$80	$0.40	126,800	1,191,306
7/18/2002	13:08:14	4,000	$3.650		$6.89	$1,600	$0.40	130,800	1,187,306
7/18/2002	13:12:46	4,000	$3.650		$6.89	$1,600	$0.40	134,800	1,183,306
7/19/2002	9:31:22	500	$3.500		$6.89	$200	$0.40	135,300	1,182,806
7/19/2002	9:32:03	400	$3.500		$6.89	$160	$0.40	135,700	1,182,406

7/22/2002	10:41:29	1,000	$3.140		$6.89	$400	$0.40	136,700	1,181,406
7/22/2002	10:42:37	500	$3.140		$6.89	$200	$0.40	137,200	1,180,906
7/22/2002	10:45:21	500	$3.140		$6.89	$200	$0.40	137,700	1,180,406
7/22/2002	12:23:55	100	$3.050		$6.89	$40	$0.40	137,800	1,180,306
7/22/2002	12:24:01	500	$3.100		$6.89	$200	$0.40	138,300	1,179,806
7/23/2002	10:08:03	1,500	$3.000		$6.89	$600	$0.40	139,800	1,178,306
7/23/2002	10:09:15	500	$3.000		$6.89	$200	$0.40	140,300	1,177,806
7/23/2002	10:10:08	500	$2.900		$6.89	$200	$0.40	140,800	1,177,306
7/23/2002	10:36:10	500	$3.000	SLD	$6.89	$200	$0.40	141,300	1,176,806
7/23/2002	14:16:33	800	$2.850		$6.89	$320	$0.40	142,100	1,176,006
7/23/2002	15:00:18	1,000	$3.000		$6.89	$400	$0.40	143,100	1,175,006
7/23/2002	15:02:31	200	$3.000		$6.89	$80	$0.40	143,300	1,174,806
7/24/2002	9:31:20	500	$2.800		$6.89	$200	$0.40	143,800	1,174,306
7/24/2002	13:42:59	1,000	$2.850		$6.89	$400	$0.40	144,800	1,173,306
7/24/2002	13:44:13	2,000	$2.600		$6.89	$800	$0.40	146,800	1,171,306
7/24/2002	13:45:00	500	$2.600		$6.89	$200	$0.40	147,300	1,170,806
7/24/2002	13:45:29	2,500	$2.600		$6.89	$1,000	$0.40	149,800	1,168,306
7/24/2002	13:45:41	500	$2.580		$6.89	$200	$0.40	150,300	1,167,806
7/24/2002	13:46:09	2,000	$2.600		$6.89	$800	$0.40	152,300	1,165,806
7/24/2002	13:46:16	1,000	$2.400		$6.89	$400	$0.40	153,300	1,164,806
7/24/2002	14:20:16	300	$2.250		$6.89	$120	$0.40	153,600	1,164,506
7/24/2002	14:20:39	300	$2.250		$6.89	$120	$0.40	153,900	1,164,206
7/30/2002	11:02:52	1,000	$2.650		$6.89	$400	$0.40	154,900	1,163,206
7/30/2002	11:03:01	500	$2.700		$6.89	$200	$0.40	155,400	1,162,706
7/30/2002	11:18:29	500	$2.650	SLD	$6.89	$200	$0.40	155,900	1,162,206
8/1/2002	15:24:28	1,000	$2.900		$6.89	$400	$0.40	156,900	1,161,206
8/1/2002	15:26:18	1,000	$2.800		$6.89	$400	$0.40	157,900	1,160,206
8/1/2002	15:46:33	1,000	$2.900		$6.89	$400	$0.40	158,900	1,159,206
8/1/2002	15:47:40	1,700	$3.000		$6.89	$680	$0.40	160,600	1,157,506
8/1/2002	15:49:37	1,000	$2.800	SLD	$6.89	$400	$0.40	161,600	1,156,506
8/1/2002	15:50:02	1,700	$3.000	SLD	$6.89	$680	$0.40	163,300	1,154,806
8/5/2002	10:11:41	500	$3.000		$6.89	$200	$0.40	163,800	1,154,306
8/5/2002	10:12:04	1,000	$3.100		$6.89	$400	$0.40	164,800	1,153,306
8/5/2002	10:12:45	500	$3.280		$6.89	$200	$0.40	165,300	1,152,806
8/5/2002	11:43:58	500	$3.400		$6.89	$200	$0.40	165,800	1,152,306
8/5/2002	14:53:24	300	$3.250		$6.89	$120	$0.40	166,100	1,152,006
8/6/2002	11:08:42	500	$3.500		$6.89	$200	$0.40	166,600	1,151,506

8/6/2002	12:36:30	200	$3.500		$6.89	$80	$0.40	166,800	1,151,306
8/6/2002	15:07:17	500	$3.600		$6.89	$200	$0.40	167,300	1,150,806
8/7/2002	12:54:00	800	$3.900		$6.89	$320	$0.40	168,100	1,150,006
8/7/2002	13:06:57	300	$3.900		$6.89	$120	$0.40	168,400	1,149,706
8/7/2002	14:02:50	800	$3.900		$6.89	$320	$0.40	169,200	1,148,906
8/7/2002	15:59:26	100	$3.900		$6.89	$40	$0.40	169,300	1,148,806
8/9/2002	9:51:20	2,000	$3.900	SLD	$6.89	$800	$0.40	171,300	1,146,806
8/9/2002	10:47:33	1,000	$3.800		$6.89	$400	$0.40	172,300	1,145,806
8/9/2002	15:38:13	1,000	$3.700		$6.89	$400	$0.40	173,300	1,144,806
8/9/2002	15:38:13	1,000	$3.750		$6.89	$400	$0.40	174,300	1,143,806
8/9/2002	15:39:37	100	$3.800		$6.89	$40	$0.40	174,400	1,143,706
8/12/2002	10:41:24	12,000	$3.750		$6.89	$4,800	$0.40	186,400	1,131,706
8/12/2002	11:45:49	700	$3.500		$6.89	$280	$0.40	187,100	1,131,006
8/12/2002	11:46:26	1,000	$3.500		$6.89	$400	$0.40	188,100	1,130,006
8/12/2002	13:35:53	1,400	$3.700		$6.89	$560	$0.40	189,500	1,128,606
8/12/2002	15:06:33	900	$3.600		$6.89	$360	$0.40	190,400	1,127,706
8/13/2002	10:47:13	1,000	$3.500		$6.89	$400	$0.40	191,400	1,126,706
8/13/2002	10:49:28	1,000	$3.500		$6.89	$400	$0.40	192,400	1,125,706
8/13/2002	10:50:49	1,000	$3.500		$6.89	$400	$0.40	193,400	1,124,706
8/13/2002	10:52:31	1,000	$3.600		$6.89	$400	$0.40	194,400	1,123,706
8/14/2002	9:37:46	1,000	$3.200		$6.89	$400	$0.40	195,400	1,122,706
8/14/2002	9:51:01	700	$3.200		$6.89	$280	$0.40	196,100	1,122,006
8/14/2002	9:53:42	6,000	$3.170		$6.89	$2,400	$0.40	202,100	1,116,006
8/14/2002	10:18:08	500	$3.150		$6.89	$200	$0.40	202,600	1,115,506
8/14/2002	10:44:41	200	$3.150		$6.89	$80	$0.40	202,800	1,115,306
8/15/2002	9:34:56	500	$3.050		$6.89	$200	$0.40	203,300	1,114,806
8/15/2002	9:36:14	500	$3.000		$6.89	$200	$0.40	203,800	1,114,306
8/15/2002	9:36:53	500	$2.900		$6.89	$200	$0.40	204,300	1,113,806
8/15/2002	9:39:50	500	$2.800		$6.89	$200	$0.40	204,800	1,113,306
8/15/2002	9:41:25	1,000	$2.500		$6.89	$400	$0.40	205,800	1,112,306
8/15/2002	10:01:37	200	$2.500		$6.89	$80	$0.40	206,000	1,112,106
8/15/2002	10:32:37	1,000	$2.500		$6.89	$400	$0.40	207,000	1,111,106
8/15/2002	14:33:24	1,000	$2.520		$6.89	$400	$0.40	208,000	1,110,106
8/15/2002	14:33:33	1,000	$2.520		$6.89	$400	$0.40	209,000	1,109,106
8/15/2002	14:39:19	1,000	$2.520		$6.89	$400	$0.40	210,000	1,108,106
8/15/2002	14:41:49	2,500	$2.520		$6.89	$1,000	$0.40	212,500	1,105,606
8/15/2002	14:43:39	500	$2.500		$6.89	$200	$0.40	213,000	1,105,106

8/15/2002	14:44:37	500	$2.500		$6.89	$200	$0.40	213,500	1,104,606
8/15/2002	14:45:28	500	$2.500		$6.89	$200	$0.40	214,000	1,104,106
8/15/2002	14:48:44	2,500	$2.550		$6.89	$1,000	$0.40	216,500	1,101,606
8/16/2002	10:40:52	1,000	$2.250		$6.89	$400	$0.40	217,500	1,100,606
8/16/2002	10:42:13	500	$2.250		$6.89	$200	$0.40	218,000	1,100,106
8/16/2002	10:43:17	500	$2.200		$6.89	$200	$0.40	218,500	1,099,606
8/16/2002	10:53:01	1,000	$2.000		$6.89	$400	$0.40	219,500	1,098,606
8/16/2002	10:54:44	500	$2.000		$6.89	$200	$0.40	220,000	1,098,106
8/16/2002	10:55:03	500	$2.000		$6.89	$200	$0.40	220,500	1,097,606
8/16/2002	10:57:20	500	$2.000		$6.89	$200	$0.40	221,000	1,097,106
8/16/2002	10:57:26	500	$1.950		$6.89	$200	$0.40	221,500	1,096,606
8/16/2002	10:58:23	500	$1.860		$6.89	$200	$0.40	222,000	1,096,106
8/16/2002	10:59:35	500	$1.850		$6.89	$200	$0.40	222,500	1,095,606
8/16/2002	11:00:28	500	$1.850		$6.89	$200	$0.40	223,000	1,095,106
8/16/2002	11:00:59	500	$1.800		$6.89	$200	$0.40	223,500	1,094,606
8/16/2002	11:01:58	500	$1.750		$6.89	$200	$0.40	224,000	1,094,106
8/16/2002	11:16:59	500	$2.000		$6.89	$200	$0.40	224,500	1,093,606
8/16/2002	11:17:28	500	$2.000		$6.89	$200	$0.40	225,000	1,093,106
8/16/2002	11:26:10	500	$2.000		$6.89	$200	$0.40	225,500	1,092,606
8/16/2002	11:37:03	500	$2.000		$6.89	$200	$0.40	226,000	1,092,106
8/16/2002	11:39:11	500	$2.000		$6.89	$200	$0.40	226,500	1,091,606
8/16/2002	11:39:58	500	$2.000		$6.89	$200	$0.40	227,000	1,091,106
8/16/2002	11:41:35	2,500	$2.000		$6.89	$1,000	$0.40	229,500	1,088,606
8/16/2002	11:43:24	500	$2.000		$6.89	$200	$0.40	230,000	1,088,106
8/16/2002	11:51:18	500	$2.000		$6.89	$200	$0.40	230,500	1,087,606
8/16/2002	12:07:09	500	$2.000		$6.89	$200	$0.40	231,000	1,087,106
8/16/2002	13:32:56	500	$2.000		$6.89	$200	$0.40	231,500	1,086,606
8/16/2002	14:30:25	500	$2.000		$6.89	$200	$0.40	232,000	1,086,106
8/16/2002	14:31:49	1,500	$2.000		$6.89	$600	$0.40	233,500	1,084,606
8/16/2002	15:12:53	500	$1.950		$6.89	$200	$0.40	234,000	1,084,106
8/16/2002	15:52:05	6,700	$2.200	SLD	$6.89	$2,680	$0.40	240,700	1,077,406
8/19/2002	9:58:07	200	$2.100		$6.89	$80	$0.40	240,900	1,077,206
8/19/2002	10:11:22	500	$2.100		$6.89	$200	$0.40	241,400	1,076,706
8/19/2002	10:13:51	500	$2.250		$6.89	$200	$0.40	241,900	1,076,206
8/19/2002	10:14:00	600	$2.250		$6.89	$240	$0.40	242,500	1,075,606
8/20/2002	10:04:13	500	$2.100		$6.89	$200	$0.40	243,000	1,075,106
8/21/2002	9:59:36	500	$1.750		$6.89	$200	$0.40	243,500	1,074,606

8/21/2002	10:00:42	1,000	$1.800		$6.89	$400	$0.40	244,500	1,073,606
8/21/2002	10:00:43	1,000	$1.750		$6.89	$400	$0.40	245,500	1,072,606
8/21/2002	10:01:48	900	$1.800		$6.89	$360	$0.40	246,400	1,071,706
8/21/2002	10:02:00	1,500	$1.750		$6.89	$600	$0.40	247,900	1,070,206
8/21/2002	10:47:26	500	$1.800		$6.89	$200	$0.40	248,400	1,069,706
8/21/2002	11:34:09	500	$1.830		$6.89	$200	$0.40	248,900	1,069,206
8/21/2002	11:40:40	2,000	$1.830		$6.89	$800	$0.40	250,900	1,067,206
8/21/2002	11:41:09	1,000	$1.800		$6.89	$400	$0.40	251,900	1,066,206
8/21/2002	11:41:35	100	$1.800		$6.89	$40	$0.40	252,000	1,066,106
8/21/2002	12:40:34	1,500	$1.770		$6.89	$600	$0.40	253,500	1,064,606
8/21/2002	12:42:10	500	$1.750		$6.89	$200	$0.40	254,000	1,064,106
8/21/2002	12:42:18	1,000	$1.750		$6.89	$400	$0.40	255,000	1,063,106
8/21/2002	12:42:48	1,500	$1.750		$6.89	$600	$0.40	256,500	1,061,606
8/21/2002	12:58:22	500	$1.800		$6.89	$200	$0.40	257,000	1,061,106
8/21/2002	13:01:59	2,000	$1.800		$6.89	$800	$0.40	259,000	1,059,106
8/21/2002	13:02:07	500	$1.800		$6.89	$200	$0.40	259,500	1,058,606
8/21/2002	13:04:14	2,000	$1.800		$6.89	$800	$0.40	261,500	1,056,606
8/21/2002	13:22:42	100	$1.800		$6.89	$40	$0.40	261,600	1,056,506
8/21/2002	13:51:58	500	$1.750	SLD	$6.89	$200	$0.40	262,100	1,056,006
8/21/2002	13:52:39	2,000	$1.750	SLD	$6.89	$800	$0.40	264,100	1,054,006
8/21/2002	15:35:45	500	$1.800		$6.89	$200	$0.40	264,600	1,053,506
8/21/2002	15:35:49	100	$1.800		$6.89	$40	$0.40	264,700	1,053,406
8/21/2002	15:44:21	500	$1.800		$6.89	$200	$0.40	265,200	1,052,906
8/21/2002	15:47:25	1,500	$1.800		$6.89	$600	$0.40	266,700	1,051,406
8/21/2002	15:54:08	400	$1.750		$6.89	$160	$0.40	267,100	1,051,006
8/22/2002	9:47:07	100	$1.800		$6.89	$40	$0.40	267,200	1,050,906
8/22/2002	14:22:44	1,000	$1.750		$6.89	$400	$0.40	268,200	1,049,906
8/22/2002	14:23:42	1,000	$1.750		$6.89	$400	$0.40	269,200	1,048,906
8/22/2002	14:24:22	500	$1.750		$6.89	$200	$0.40	269,700	1,048,406
8/22/2002	14:30:55	1,500	$1.670		$6.89	$600	$0.40	271,200	1,046,906
8/23/2002	10:04:06	500	$1.800		$6.89	$200	$0.40	271,700	1,046,406
8/23/2002	10:06:11	1,500	$1.800		$6.89	$600	$0.40	273,200	1,044,906
8/23/2002	10:21:48	500	$1.750		$6.89	$200	$0.40	273,700	1,044,406
8/23/2002	10:22:20	500	$1.750		$6.89	$200	$0.40	274,200	1,043,906
8/23/2002	10:25:22	500	$1.750		$6.89	$200	$0.40	274,700	1,043,406
8/23/2002	10:26:33	500	$1.750		$6.89	$200	$0.40	275,200	1,042,906
8/23/2002	10:29:44	500	$1.750		$6.89	$200	$0.40	275,700	1,042,406

8/23/2002	10:33:55	500	$1.800		$6.89	$200	$0.40	276,200	1,041,906
8/23/2002	10:33:55	500	$1.750		$6.89	$200	$0.40	276,700	1,041,406
8/23/2002	10:44:14	1,000	$1.800		$6.89	$400	$0.40	277,700	1,040,406
8/23/2002	10:47:48	500	$1.800		$6.89	$200	$0.40	278,200	1,039,906
8/23/2002	10:50:29	3,000	$1.800		$6.89	$1,200	$0.40	281,200	1,036,906
8/23/2002	12:12:46	1,300	$1.900		$6.89	$520	$0.40	282,500	1,035,606
8/23/2002	12:14:43	700	$1.800		$6.89	$280	$0.40	283,200	1,034,906
8/23/2002	12:15:51	700	$1.800		$6.89	$280	$0.40	283,900	1,034,206
8/23/2002	12:56:39	3,000	$1.900		$6.89	$1,200	$0.40	286,900	1,031,206
8/23/2002	12:56:39	3,000	$1.800		$6.89	$1,200	$0.40	289,900	1,028,206
8/23/2002	13:00:58	2,000	$1.900		$6.89	$800	$0.40	291,900	1,026,206
8/23/2002	14:42:13	500	$1.900		$6.89	$200	$0.40	292,400	1,025,706
8/23/2002	14:43:30	200	$1.900		$6.89	$80	$0.40	292,600	1,025,506
8/23/2002	14:49:48	5,000	$2.000		$6.89	$2,000	$0.40	297,600	1,020,506
8/23/2002	14:54:09	2,500	$2.000		$6.89	$1,000	$0.40	300,100	1,018,006
8/23/2002	15:11:59	500	$2.000		$6.89	$200	$0.40	300,600	1,017,506
8/23/2002	15:13:27	6,000	$2.000		$6.89	$2,400	$0.40	306,600	1,011,506
8/23/2002	15:15:02	500	$1.950		$6.89	$200	$0.40	307,100	1,011,006
8/23/2002	15:34:08	6,000	$1.950		$6.89	$2,400	$0.40	313,100	1,005,006
8/23/2002	15:45:21	1,500	$1.800		$6.89	$600	$0.40	314,600	1,003,506
8/27/2002	13:47:25	500	$1.900		$6.89	$200	$0.40	315,100	1,003,006
8/27/2002	15:17:13	500	$1.800		$6.89	$200	$0.40	315,600	1,002,506
8/27/2002	15:17:49	2,500	$1.800		$6.89	$1,000	$0.40	318,100	1,000,006
8/27/2002	15:18:19	2,500	$1.800		$6.89	$1,000	$0.40	320,600	997,506
8/27/2002	15:18:21	600	$1.800		$6.89	$240	$0.40	321,200	996,906
8/27/2002	15:49:38	700	$1.800		$6.89	$280	$0.40	321,900	996,206
8/27/2002	15:49:54	700	$1.800		$6.89	$280	$0.40	322,600	995,506
8/27/2002	15:57:40	500	$1.900		$6.89	$200	$0.40	323,100	995,006
8/27/2002	16:00:08	500	$2.000	T	$6.89	$200	$0.40	323,600	994,506
8/27/2002	16:00:37	1,300	$2.000	T	$6.89	$520	$0.40	324,900	993,206
8/27/2002	16:02:49	500	$1.990	T	$6.89	$200	$0.40	325,400	992,706
8/29/2002	14:55:58	500	$1.900		$6.89	$200	$0.40	325,900	992,206
9/5/2002	10:37:45	500	$1.950		$6.89	$200	$0.40	326,400	991,706
9/5/2002	10:38:37	500	$1.950		$6.89	$200	$0.40	326,900	991,206
9/5/2002	14:28:39	100	$1.950		$6.89	$40	$0.40	327,000	991,106
9/6/2002	10:38:35	500	$1.950		$6.89	$200	$0.40	327,500	990,606
9/6/2002	10:42:00	1,000	$1.950		$6.89	$400	$0.40	328,500	989,606

9/6/2002	10:42:07	1,000	$1.960	$6.89	$400	$0.40	329,500	988,606
9/9/2002	9:31:20	300	$1.750	$6.89	$120	$0.40	329,800	988,306
9/9/2002	14:23:48	300	$1.700	$6.89	$120	$0.40	330,100	988,006
9/9/2002	15:05:06	100	$1.700	$6.89	$40	$0.40	330,200	987,906
9/9/2002	15:05:06	100	$1.900	$6.89	$40	$0.40	330,300	987,806
9/10/2002	15:51:14	500	$1.850	$6.89	$200	$0.40	330,800	987,306
9/10/2002	15:51:42	500	$1.850	$6.89	$200	$0.40	331,300	986,806
9/10/2002	15:51:46	1,000	$1.900	$6.89	$400	$0.40	332,300	985,806
9/10/2002	15:52:33	500	$1.900	$6.89	$200	$0.40	332,800	985,306
9/10/2002	15:53:03	1,000	$1.870	$6.89	$400	$0.40	333,800	984,306
9/10/2002	15:55:29	500	$1.900	$6.89	$200	$0.40	334,300	983,806
9/10/2002	15:55:36	500	$1.870	$6.89	$200	$0.40	334,800	983,306
9/10/2002	15:58:26	1,000	$1.900	$6.89	$400	$0.40	335,800	982,306
9/10/2002	15:58:27	1,000	$1.870	$6.89	$400	$0.40	336,800	981,306
9/11/2002	12:17:44	500	$1.900	$6.89	$200	$0.40	337,300	980,806
9/11/2002	13:02:21	500	$1.900	$6.89	$200	$0.40	337,800	980,306
9/12/2002	15:52:49	500	$1.850	$6.89	$200	$0.40	338,300	979,806
9/12/2002	15:53:08	500	$1.850	$6.89	$200	$0.40	338,800	979,306
9/12/2002	15:53:16	500	$1.900	$6.89	$200	$0.40	339,300	978,806
9/12/2002	15:53:18	1,000	$1.900	$6.89	$400	$0.40	340,300	977,806
9/12/2002	15:56:18	500	$1.900	$6.89	$200	$0.40	340,800	977,306
9/13/2002	10:50:18	500	$1.900	$6.89	$200	$0.40	341,300	976,806
9/13/2002	11:42:29	200	$1.850	$6.89	$80	$0.40	341,500	976,606
9/13/2002	15:54:12	500	$1.900	$6.89	$200	$0.40	342,000	976,106
9/16/2002	10:11:57	500	$1.880	$6.89	$200	$0.40	342,500	975,606
9/16/2002	10:20:04	600	$1.880	$6.89	$240	$0.40	343,100	975,006
9/16/2002	10:21:14	500	$1.850	$6.89	$200	$0.40	343,600	974,506
9/16/2002	10:22:02	1,000	$1.850	$6.89	$400	$0.40	344,600	973,506
9/16/2002	10:29:27	700	$1.880	$6.89	$280	$0.40	345,300	972,806
9/16/2002	10:30:01	700	$1.880	$6.89	$280	$0.40	346,000	972,106
9/16/2002	10:30:01	700	$1.850	$6.89	$280	$0.40	346,700	971,406
9/16/2002	10:41:46	500	$1.850	$6.89	$200	$0.40	347,200	970,906
9/16/2002	12:39:31	500	$1.880	$6.89	$200	$0.40	347,700	970,406
9/16/2002	12:39:45	100	$1.750	$6.89	$40	$0.40	347,800	970,306
9/16/2002	14:54:29	500	$1.880	$6.89	$200	$0.40	348,300	969,806
9/16/2002	14:54:30	200	$1.850	$6.89	$80	$0.40	348,500	969,606
9/16/2002	14:58:07	1,000	$1.880	$6.89	$400	$0.40	349,500	968,606

9/16/2002	15:38:34	500	$1.850		$6.89	$200	$0.40	350,000	968,106
9/16/2002	15:38:43	2,500	$1.850		$6.89	$1,000	$0.40	352,500	965,606
9/16/2002	15:59:54	3,000	$1.880		$6.89	$1,200	$0.40	355,500	962,606
9/17/2002	9:42:18	1,000	$1.950		$6.89	$400	$0.40	356,500	961,606
9/17/2002	9:55:19	500	$1.950		$6.89	$200	$0.40	357,000	961,106
9/17/2002	9:55:30	1,500	$1.950		$6.89	$600	$0.40	358,500	959,606
9/17/2002	10:12:06	500	$1.950		$6.89	$200	$0.40	359,000	959,106
9/17/2002	10:12:17	2,000	$1.950		$6.89	$800	$0.40	361,000	957,106
9/17/2002	10:12:38	5,500	$2.000		$6.89	$2,200	$0.40	366,500	951,606
9/17/2002	10:22:52	500	$1.990		$6.89	$200	$0.40	367,000	951,106
9/17/2002	12:15:21	100	$1.950		$6.89	$40	$0.40	367,100	951,006
9/17/2002	12:44:11	1,000	$1.950		$6.89	$400	$0.40	368,100	950,006
9/17/2002	15:04:47	100	$2.000		$6.89	$40	$0.40	368,200	949,906
9/17/2002	15:05:07	500	$2.000		$6.89	$200	$0.40	368,700	949,406
9/17/2002	15:43:23	500	$1.950		$6.89	$200	$0.40	369,200	948,906
9/17/2002	15:43:28	500	$1.950		$6.89	$200	$0.40	369,700	948,406
9/17/2002	16:02:48	3,000	$2.000	T	$6.89	$1,200	$0.40	372,700	945,406
9/18/2002	10:22:47	500	$1.950		$6.89	$200	$0.40	373,200	944,906
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9/19/2002	14:13:24	1,900	$1.900		$6.89	$760	$0.40	377,100	941,006
9/19/2002	14:55:17	100	$1.900		$6.89	$40	$0.40	377,200	940,906
9/19/2002	16:03:32	2,500	$1.950	T	$6.89	$1,000	$0.40	379,700	938,406
9/20/2002	10:58:12	500	$1.900		$6.89	$200	$0.40	380,200	937,906
9/20/2002	10:58:19	500	$1.900		$6.89	$200	$0.40	380,700	937,406
9/20/2002	11:52:57	500	$1.900		$6.89	$200	$0.40	381,200	936,906
9/20/2002	11:53:01	500	$1.900		$6.89	$200	$0.40	381,700	936,406
9/20/2002	12:04:26	500	$1.900		$6.89	$200	$0.40	382,200	935,906
9/20/2002	16:07:16	1,500	$2.000	T	$6.89	$600	$0.40	383,700	934,406
9/20/2002	16:08:56	1,500	$2.050	T	$6.89	$600	$0.40	385,200	932,906
9/20/2002	16:09:44	1,500	$1.950	T	$6.89	$600	$0.40	386,700	931,406
9/23/2002	10:41:34	500	$1.900		$6.89	$200	$0.40	387,200	930,906
9/23/2002	10:41:39	1,000	$1.900		$6.89	$400	$0.40	388,200	929,906
9/23/2002	10:42:16	2,000	$2.000		$6.89	$800	$0.40	390,200	927,906
9/23/2002	11:06:00	500	$1.850		$6.89	$200	$0.40	390,700	927,406

9/23/2002	15:14:59	500	$1.950		$6.89	$200	$0.40	391,200	926,906
9/23/2002	15:39:52	500	$1.900		$6.89	$200	$0.40	391,700	926,406

$129,504	Maximum Possible Economic Harm to Thane Shares Traded 5/24/02-9/23/02
370,562	Maximum Possible Economic Harm to Thane Shares Held Through 9/23/02
$500,066	Maximum Possible Economic Harm to Thane Shareholders

Data Source: OTC Bulletin Board

Notes: SLD – Late Trade

T – Pre-Opening or after hours trade.

APPENDIX L

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA
SOUTHERN DIVISION

HOWARD MILLER, on behalf of himself and all others similarly situated,	)	Case No. SA CV 03-1031 JVS (SGLx)
Plaintiff,	)	
vs.	)	
THANE INTERNATIONAL, INC., WILLIAM F. HAY, DENISE DUBARRY-HAY, KEVIN MCKEON and MARK TAYLOR,	)	
Defendants.	)	

EXHIBIT 188-D

* * *

APPENDIX M

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA
SOUTHERN DIVISION

HOWARD MILLER, on behalf of himself and all others similarly situated,	)	Case No. SA CV 03-1031 JVS (SGLx)
Plaintiff,	)	
vs.	)	
THANE INTERNATIONAL, INC., WILLIAM F. HAY, DENISE DUBARRY-HAY, KEVIN MCKEON and MARK TAYLOR,	)	
Defendants.	)	

EXHIBIT 189-D

* * *

APPENDIX N

UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA
SOUTHERN DIVISION

HOWARD MILLER, on behalf of himself and all others similarly situated,	)	Case No. SA CV 03-1031 JVS (SGLx)
Plaintiff,	)	
vs.	)	
THANE INTERNATIONAL, INC., WILLIAM F. HAY, DENISE DUBARRY-HAY, KEVIN MCKEON and MARK TAYLOR,	)	
Defendants.	)	

EXHIBIT 190-D

* * *

APPENDIX O

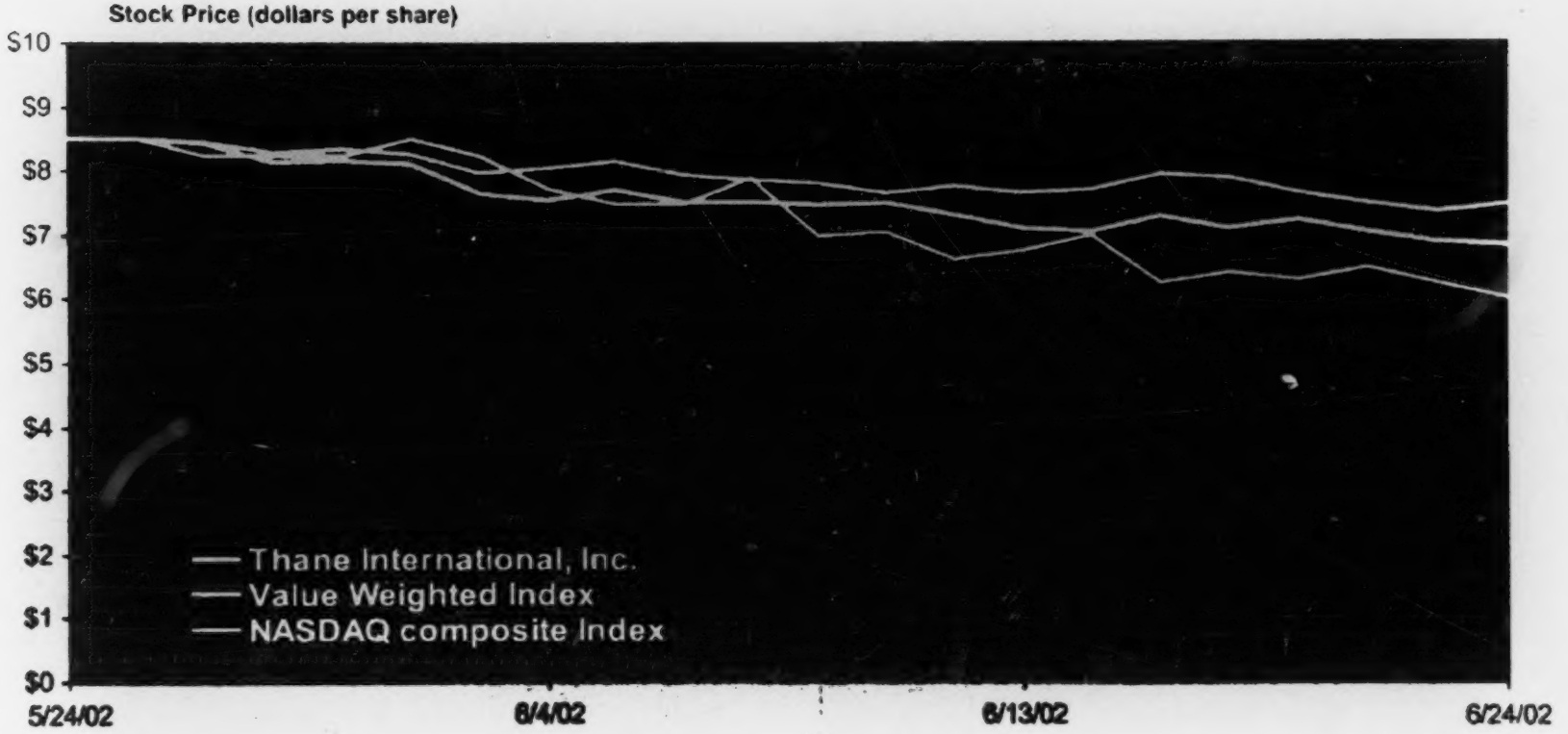
UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA
SOUTHERN DIVISION

HOWARD MILLER, on behalf of himself and all others similarly situated,	)	Case No. SA CV 03-1031 JVS (SGLx)
Plaintiff,	)	
vs.	)	
THANE INTERNATIONAL, INC., WILLIAM F. HAY, DENISE DUBARRY-HAY, KEVIN MCKEON and MARK TAYLOR,	)	
Defendants.	)	

EXHIBIT 191-D

* * *

Thane International vs.
Value Weighted Peer Group and NASDAQ Composite Indices
May 24, 2002 - June 24, 2002



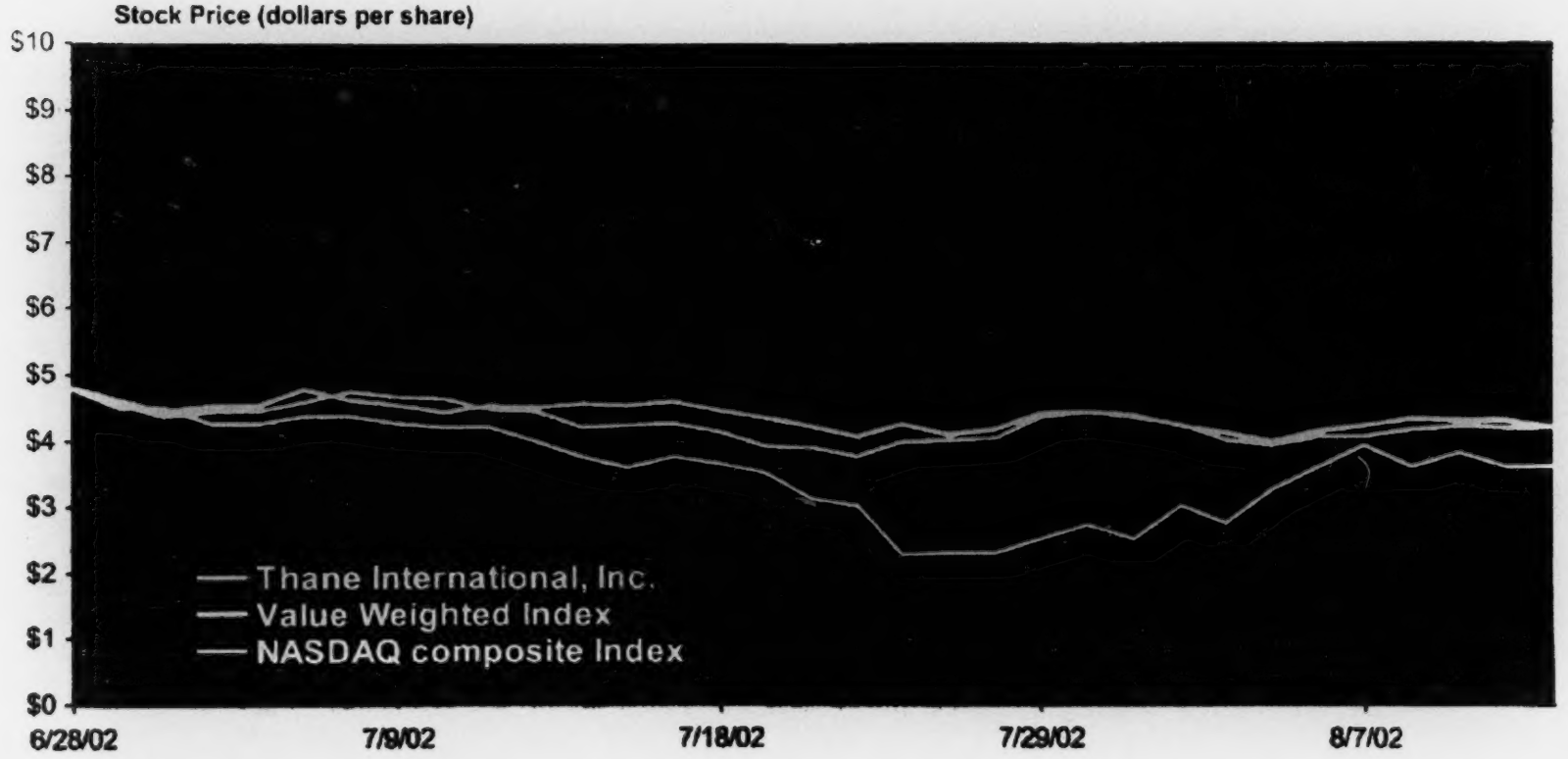
Source: IDC, Bloomberg

Notes: Value Weighted Index is comprised of the following comparable companies: Helen of Troy, Ltd., Nautilus Group Inc., Cross Media Marketing Corp., Valuevision Media Inc., and Concepts Direct Inc.

Value weighted index and NASDAQ Composite Index are indexed to Thane International Inc.'s stock price on 5/24/02 (IPO Date), $8.50.

Thane International vs.
Value Weighted Peer Group and NASDAQ Composite Indices

June 28, 2002 - August 13, 2002

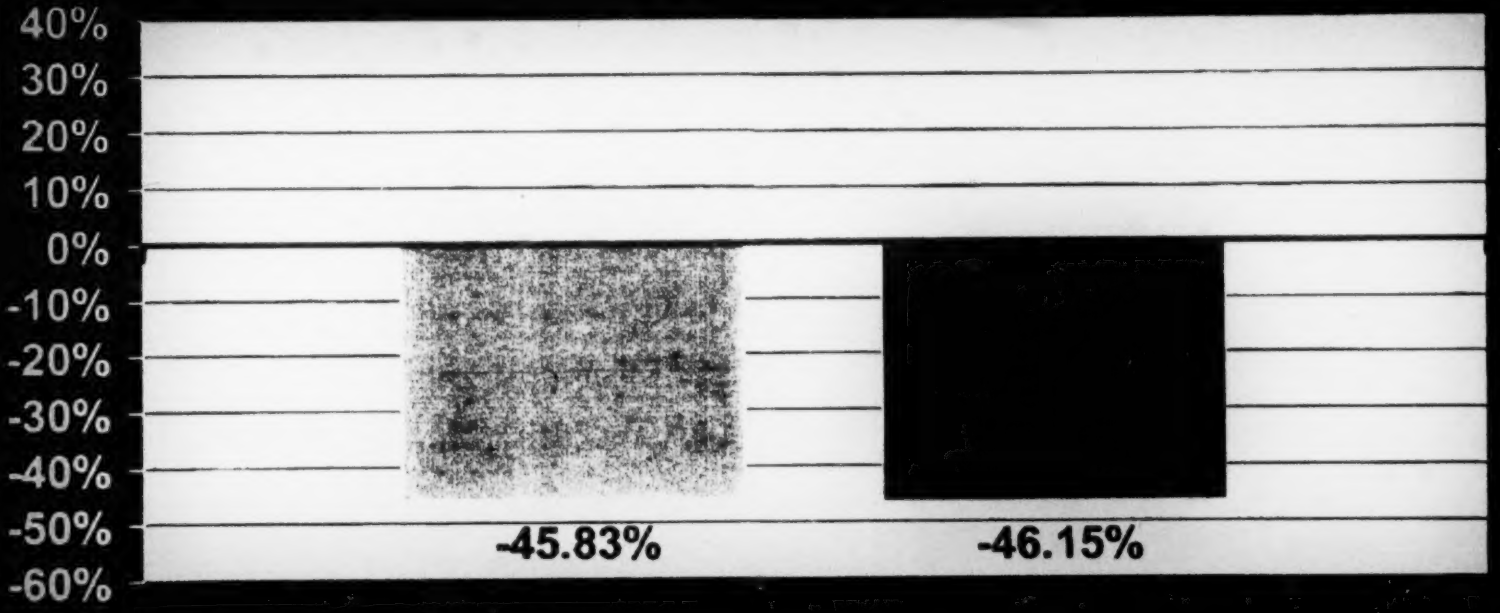


Source: IDC, Bloomberg

Notes: Value Weighted Index is comprised of the following comparable companies: Helen of Troy, Ltd., Nautilus Group Inc., Cross Media Marketing Corp., Valuevision Media Inc., and Concepts Direct Inc.

Value weighted Index and NASDAQ Composite Index are indexed to Thane International Inc.'s stock price on 6/28/02, $4.80.

Thane's Stock Price Decline After the August 14, 2002 Earnings Announcement was in Proportion to the Announced Decrease in Earnings Per Share



Source: IDC; PR Newswire

APPENDIX P

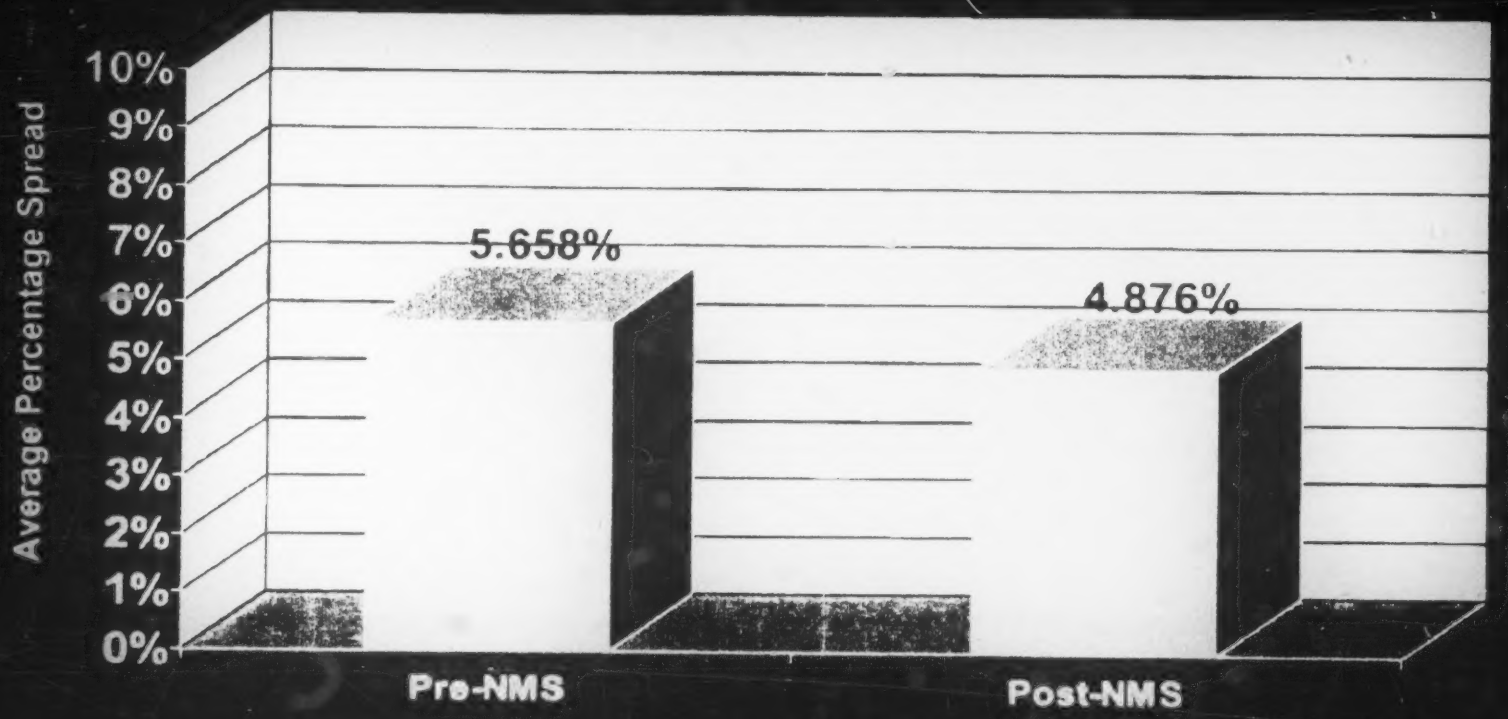
UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA
SOUTHERN DIVISION

HOWARD MILLER, on behalf of himself and all others similarly situated,	)	Case No. SA CV 03-1031 JVS (SGLx)
Plaintiff,	)	
vs.	)	
THANE INTERNATIONAL, INC., WILLIAM F. HAY, DENISE DUBARRY-HAY, KEVIN MCKEON and MARK TAYLOR,	)	
Defendants.	)	

EXHIBIT 192-D

* * *

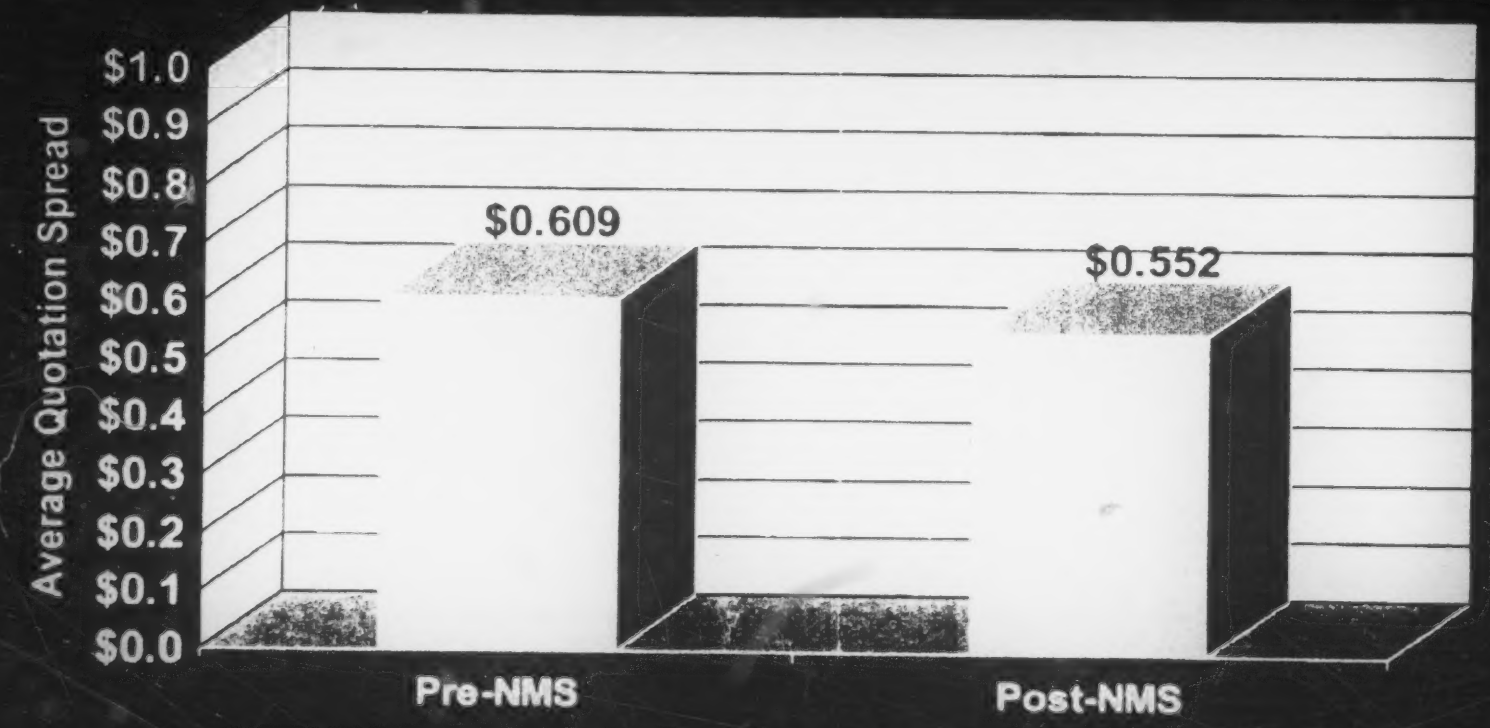
According To The Authorities Cited By Plaintiffs' Expert, Average Percentage Spreads Only Changed by 0.782% When Companies Moved to the NMS from NASDAQ



Sample of 461 NASDAQ-to-NMS transfers between April 1982 and December 1987

Source: **Trial Exhibit 43** - Kent Baker and Richard B. Edelman, "The Effects on Spread and Volume of Switching to the NASDAQ National Market System," *Financial Analysts Journal*, January-February 1992.

According To The Authorities Cited By Plaintiffs' Expert, Average Quotation Spreads Only Changed by $0.057 When Companies Moved to the NMS from NASDAQ



Sample of 461 NASDAQ-to-NMS transfers between April 1982 and December 1987

Source: **Trial Exhibit 43** -- Kent Baker and Richard B. Edelman, "The Effects on Spread and Volume of Switching to the NASDAQ National Market System," *Financial Analysts Journal*, January-February 1992.

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(2)

No. 07-1577

FILED

JUL 18 2008

OFFICE OF THE CLERK
SUPREME COURT, U.S.

IN THE

Supreme Court of the United States

THANE INTERNATIONAL, INC., *et al.*,

Petitioners,

v.

JOSEPH J. MILKOWSKI, *et al.*,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

BRIEF IN OPPOSITION

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QUESTIONS PRESENTED

1. Whether petitioners have presented compelling reasons to grant the petition, where the Ninth Circuit's opinion reversing the district court and remanding this action for further proceedings is not a final order and petitioners failed even to suggest any argument supporting interlocutory review.

2. Whether petitioners have presented compelling reasons to grant the petition on the basis that the Ninth Circuit exceeded its authority under Fed. R. Civ. P. 52(a) where it simply applied the applicable rule of law to uncontested facts.

3. Whether petitioners have presented compelling reasons to grant the petition where the Ninth Circuit's holding that the misrepresentations were material does not conflict with a decision of this Court, involve a split in the circuits, or implicate a Federal question that has not been settled by this Court.

TABLE OF CONTENTS

	Page
QUESTIONS PRESENTED	i
TABLE OF CONTENTS	ii
TABLE OF CITED AUTHORITIES	iv
INTRODUCTION	1
STATEMENT OF THE CASE	3
Procedural History	4
REASONS FOR DENYING THE PETITION	14
I. THE PETITION IS PREMATURE	14
II. THE RELEVANT FACTS WERE NOT IN DISPUTE AND THE NINTH CIRCUIT APPLIED THE APPROPRIATE CLEAR ERROR STANDARD UNDER FED. R. CIV. P. 52(a)	16
III. THE NINTH CIRCUIT APPLIED WELL-ESTABLISHED PRECEDENT REGARDING MARKET EFFICIENCY	20
A. The Circuit Precedents Are Uniform	20

Contents

Page

B. There Is No Split Between The Second and Ninth Circuits Regarding The Use Of Price In Cases Where The Stock Is Inefficient 26

C. The Ninth Circuit's Decision Followed This Court's Precedents .. 27

D. The Ninth Circuit's Opinion Is Well Reasoned 29

E. The Ninth Circuit's Opinion Will Not Likely Have Any Effect On The Legitimacy Of Bench Trials 32

CONCLUSION 33

TABLE OF CITED AUTHORITIES

Page

CASES

Affiliated Ute Citizens v. United States,
406 U.S. 128 (1973) 28

Akerman v. Oryx Commc'ns, Inc.,
609 F. Supp. 363 (S.D.N.Y. 1984),
aff'd, 810 F.2d 336 (2d Cir. 1987) 26, 27

Akerman v. Oryx Commc'ns, Inc.,
810 F.2d 336 (2d Cir. 1987) 27

Alexander Proudfoot Co. World Headquarters v. Thayer,
877 F.2d 912 (11th Cir. 1989) 20

Am. Constr. Co. v. Jacksonville T&K. W. Ry. Co.,
148 U.S. 372 (1893) 15

Basic Inc. v. Levinson,
485 U.S. 224 (1988) 21-22, 25, 28

Bhd. of Locomotive Firemen & Enginemen v. Bangor & Aroostook R.R. Co.,
389 U.S. 327 (1967) 15

Binder v. Gillespie,
184 F.3d 1059 (9th Cir. 1999) 22, 24, 26

Bose Corp. v. Consumers Union of U.S., Inc.,
466 U.S. 485 (1984) 18

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Page

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711 F. Supp. 1264 (D.N.J. 1989) ..... *passim*

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532 U.S. 234 (2001) 7, 17, 18, 20

Eckstein v. Balcor Film Invs.,
8 F.3d 1121 (7th Cir. 1993) 29

Freeman v. Laventhol & Horwath,
915 F.2d 193 (6th Cir. 1990) 27

Gillespie v. United States Steel Corp.,
379 U.S. 148 (1964) 15, 16

Hall v. Nat'l Gypsum Co.,
105 F.3d 225 (5th Cir. 1997) 19

Hamilton-Brown Shoe Co. v. Wolf Bros. & Co.,
240 U.S. 251 (1916) 14

In re Burlington Coat Factory Sec. Litig.,
114 F.3d 1410 (3d Cir. 1997) 30

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471 F.3d 24 (2d Cir. 2006) 27

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306 F.3d 1314 (3d Cir. 2002) 30

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Page

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224 F.R.D. 27 (D. Mass. 2004) 25

In re PolyMedica Corp. Sec. Litig.,
432 F.3d 1 (1st Cir. 2005) 23, 24, 31

In re SCOR Holding (Switzerland) AG Litig.,
537 F. Supp. 2d 556 (S.D.N.Y. 2008) 27

In re Xcelera.com Sec. Litig.,
430 F.3d 503 (1st Cir. 2005) 24

Land v. Dollar,
330 U.S. 731 (1947) 16

Larson v. Domestic & Foreign Commerce Corp.,
337 U.S. 682 (1949) 16

McFarland v. T.E. Mercer Trucking Co.,
781 F.2d 1146 (5th Cir. 1986) 19

Nathenson v. Zonagen, Inc.,
267 F.3d 400 (5th Cir. 2001) 31

Office of Senator Mark Dayton v. Hanson,
127 S. Ct. 2018 (2007) 14

Padilla-Manqual v. Pavia Hosp.,
516 F.3d 29 (1st Cir. 2008) 20

Cited Authorities

Page

TSC Indus., Inc. v. Northway, Inc.,
426 U.S. 438 (1976) 27-28

Unger v. Amedisys Inc.,
401 F.3d 316 (5th Cir. 2005) 23, 24, 26

United States v. Gen. Motors Corp.,
323 U.S. 373 (1945) 15, 16

Virginia Military Inst. v. United States,
508 U.S. 946 (1993) 14

STATUTES AND RULES

15 U.S.C. § 77l(a)(2) 3

15 U.S.C. § 77o 3

Fed. R. Civ. P. 23(b)(3) 21

Fed. R. Civ. P. 52(a) ..... *passim*

Sup. Ct. R. 10. 1

Page

MISCELLANEOUS

Marc Galanter, *A World Without Trials?*, 2006 J. Disp. Resol. 7 32

Kevin M. Clermont & Theodore Eisenberg, *Anti-Plaintiff Bias in Federal Appellate Courts*, 84 Judicature 128 (2000) 32

Theodore Eisenberg & Michael Heise, *Plaintiphobia in State Courts? An Empirical Study of State Court Trials on Appeal*, Cornell Legal Studies Research Paper No. 07-006 (Sept. 2007) 32

INTRODUCTION

Petitioners have not presented any compelling reasons for their petition for a writ of certiorari to be granted. *See* Sup. Ct. R. 10. Although the Ninth Circuit directed judgment in favor of respondents, it also remanded the action for further proceedings, including a determination of loss causation. There is no mention, much less discussion, in the petition of the lack of finality of the Ninth Circuit's decision. The petition should be denied as premature.

There are no compelling or extraordinary legal issues raised in the petition. Petitioners' argument that the Ninth Circuit's opinion conflicts with prior holdings of this Court regarding the application of Fed. R. Civ. P. 52(a) is premised on petitioners' contention that the Ninth Circuit dissembled when it articulated the standard of review it employed. Petitioners' disparagement of the Ninth Circuit is gratuitous, as the Ninth Circuit merely applied the correct legal standard to undisputed facts.

Petitioners contest the Ninth Circuit's determination that the district court should first have determined that the stock traded in an efficient market before relying on reported stock prices to find lack of materiality in an action brought under the securities laws. The Ninth Circuit simply corrected the district court's failure to apply controlling precedent to uncontroverted facts. Specifically, there is no dispute where, when, and by whom the misstatements at issue were made or that Thane's stock did not trade in an efficient market. After trial, the district court itself

concluded that the stock did not trade efficiently. The issue faced by the Ninth Circuit turned on whether it was appropriate for the district court to disregard uniform precedent as to when reported trading prices are determinative. There is no split between the Second and Ninth Circuits or any other Court of Appeals on the applicability of the efficient market theory in determining the materiality of a misstatement.

The Ninth Circuit's materiality holding is consistent with numerous decisions across the country which have analyzed the issue of market efficiency in the context of determining the propriety of utilizing the fraud-on-the-market presumption of reliance. Given that the Ninth Circuit's opinion corrected what the district court perceived was a foray into "unchartered waters," petitioners' contention that there is a circuit split strains credulity.

As neither the district court nor Ninth Circuit found that the stock at issue traded in an efficient market, petitioners' arguments with respect to an alleged circuit split with respect to the relationship between price and materiality in an efficient market is a *non sequitur* and should be disregarded. (*See* Petition at 34-39.) The issue before the Ninth Circuit was not the appropriate time within which a particular stock should react to news in an efficient market, *i.e.*, the degree of market efficiency, but whether one could look at reported trading prices in the absence of an initial finding of market efficiency.

STATEMENT OF THE CASE

Respondents (plaintiffs below) are former stockholders of Reliant Interactive Media Corp. ("Reliant"). Reliant was acquired by defendant Thane International, Inc. ("Thane") in a stock-for-stock merger. Petitioners – Thane and Thane's four principal executive officers, three of whom were also directors of Thane – are defendants below.

Respondents allege in their complaint that the combined proxy statement- prospectus used by petitioners (a) to induce a favorable vote by Reliant stockholders on the proposal to merge with Thane, and (b) to register the shares of Thane stock to be exchanged for Reliant stock in the event of a favorable vote, contains numerous materially misleading statements with respect to the market in which the newly-issued Thane stock would trade following the merger. Respondents allege that the proxy statement-prospectus represented that Thane's stock would trade on the National Association of Securities Dealers' National Market System ("NMS") but, despite the stock qualifying for listing on the NMS, defendants caused Thane's stock to trade on the over-the-counter market's bulletin board (the "OTCBB"). The complaint sets forth a claim for violation of Section 12(a)(2) of the Securities Act of 1933, as amended, 15 U.S.C. § 77l(a)(2), against all defendants, and a control person liability claim pursuant to Section 15 of the same Act, 15 U.S.C. § 77o,

against each of the four individual defendants. Respondents seek rescissory damages pursuant to Section 12(a)(2).[1]

Procedural History

Respondents filed their complaint in the Superior Court, Riverside County, on September 23, 2002. On October 23, 2002, petitioners removed this action to the United States District Court for the Central District of California. Petitioners' motion to dismiss was denied by order entered June 26, 2003, respondents' motion for class certification was granted by order entered November 3, 2004, and cross-motions for summary judgment were granted in part and denied in part by order entered March 4, 2005.

A bench trial was held on April 12 and 13, 2005 and closing arguments made on April 14, 2005. By decision entered June 2, 2005, the district court ruled in favor of petitioners. The district court held for petitioners because it found that (a) the alleged misrepresentations were technically truthful, and (b) even if the statements in question were actionable, they were not material. The district court, despite concluding that Thane's stock did not trade in an efficient market,[2] went on to hold that

1. Accordingly, this is not "an action for money damages" as characterized by petitioners in their second of two Questions Presented. Petition at i. The equitable nature of this action underlied petitioners' motion "to strike plaintiffs' request for a jury trial." Petition at 10.

2. The district court found that "[t]here is little doubt that Thane stock would not meet the tests for an efficient market (Cont'd)

"[i]f the Court factors in the price effect, the Court believes that listing on the NMS was not a material fact." Pet. App. at 87a. The sole basis of the district court's finding a lack of materiality was its reliance on the reported trading prices of Thane's stock on the OTCBB immediately after the merger. Such reliance on reported trading prices in the absence of first finding that Thane's stock traded in an efficient market was unprecedented and contrary to uniform analogous precedent. The district court candidly acknowledged that by relying solely on reported prices on the OTCBB to support a finding of materiality, it was "proceed[ing] into unchartered waters." Pet. App. at 89a. The district court also candidly acknowledged that it was not applying the reasoning of a seminal decision with regard to efficient markets, *Cammer v. Bloom*, *supra*, as it held that "[t]here is little doubt that Thane stock would not meet the tests for an efficient market under *Cammer*." *Id.* at 90a n.11. The district court further acknowledged that the Ninth Circuit follows *Cammer*. Pet. App. at 89a.

The district court framed the issue thus: "can one even assess the price effect in Thane given that it did not trade in an efficient market?" Pet. App. at 88a. This is purely an issue of law. The district court answered

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(Cont'd)

under *Cammer* [*v. Bloom*, 711 F. Supp. 1264, 1286-87 (D.N.J. 1989)]. Volume was relatively modest after the merger. For nearly a month, Thane had only one or two market makers. Thane was not followed by any analysts. Thane did not qualify for using SEC Form S-3. The only *Cammer* factor present to any significant degree is the empirical fact that the stock reacted to some events, such as earnings reports." Pet. App. at 90a n.11.

the question in the affirmative without citing any authority in support of its decision to rely on Thane's reported market price. All analogous authority, including that of the Ninth Circuit, is to the contrary.

Final judgment was entered on June 10, 2005 and respondents timely filed a notice of appeal on July 11, 2005. None of the issues raised on the appeal involve disputed issues of fact. The district court noted "the substantial factual stipulations which the parties made in the Pretrial Conference Order." Pet. App. at 63a.

The Ninth Circuit reversed, directed judgment in favor of respondents, and remanded for further proceedings on loss causation and other matters. Petitioners sought a rehearing and suggestion of rehearing *en banc* in which they stated, among other things, that "an appellate court [should] not reverse a factual determination unless it comes away with a 'definite and firm conviction' that an error has been made." Petition For Rehearing and Suggestion of Rehearing *En Banc* at 16. The petition for rehearing and suggestion of rehearing *en banc* was presented to the entire Ninth Circuit and, as no active judge requested a vote on whether to rehear the matter, the petition was denied.

At the same time, the Ninth Circuit issued an amended opinion. After analyzing the language at issue, the Ninth Circuit found, based largely on uncontroverted documentary evidence, that petitioners

misrepresented where Thane's stock would trade.[3] The Ninth Circuit then restated, verbatim, its original express finding that it had a "'definite and firm conviction that a mistake has been committed.'" Pet. App. at 19a and 48a (quoting *Easley v. Cromartie*, 532 U.S. 234, 242 (2001)). The Ninth Circuit also found that the misrepresentations were material. Specifically, the Ninth Circuit found that the district court's consideration of "the movement in share price of a stock that did not trade on an efficient market to determine materiality under the circumstances of this case" was clear error. Pet. App. at 20a. Here, as well, all of the evidence upon which the Ninth Circuit relied was undisputed. In rendering its decision, the Ninth Circuit even "accept[ed] as true all of [petitioners' expert's] testimony" on the materiality issue thereby conclusively demonstrating the absence of any disputed factual issues. Pet. App. at 25a. On the issue of materiality, as well, the Ninth Circuit applied Fed. R. Civ. P. 52(a)'s "clear error" standard. Pet. App. at 20a.

Background Facts

Thane and Reliant executed a merger agreement on November 21, 2001, which agreement was amended in December 2001. Section 7.2(a) of the merger agreement made Reliant stockholder approval a condition precedent to the merger, while Section 2.8 provided that, upon consummation of the merger,

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3. Oral testimony could not be of any use to petitioners as they also believed that they were representing that Thane's stock would be listed on the NMS. This is evident as petitioners required Reliant and Reliant's principal stockholders to waive, in writing, the requirement to list on the NMS. Pet. App. 87a n.10.

Reliant stock would be converted into Thane stock at a specified exchange ratio.

In order to satisfy Federal and state law implicated by the proposed merger, Thane filed a registration statement with the Securities and Exchange Commission ("SEC") on January 3, 2002, and filed amendments thereto on February 21, 2002, March 29, 2002, April 23, 2002, and finally on April 26, 2002, when the registration statement was declared effective by the SEC. The proxy statement-prospectus, which is part of the registration statement, was distributed to Reliant stockholders. The registration statement served a dual purpose: the proxy statement portion of the registration statement was required in order to provide information to Reliant's stockholders concerning the proposed merger sufficient to enable them to cast an informed vote; the prospectus portion of the registration statement was necessary in order to register the shares of Thane to be exchanged for Reliant stock upon approval of the merger by Reliant's stockholders.

Prior to the merger, Thane's stock was not publicly traded. The proxy statement-prospectus was replete with various representations concerning where Thane's stock would be listed following the merger.[4] For example,

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4. Contrary to the assurances made by petitioners to this Court, the single representation reprinted in the petition is not "illustrative" of all of the representations and which representations are not "substantially similar" to one another. Petition at 7 and 7 n.2. Particularly significant is the failure of petitioners to discuss the representations concerning liquidity, quoted below, especially as these were of obvious importance to the Ninth Circuit in finding clear error. *See* Pet. App. at 28a-29a.

the proxy statement-prospectus stated as follows, beginning with its cover page:

> The shares of Thane common stock to be received by the stockholders of Reliant in connection with the merger have been approved for quotation and trading on the NASDAQ National Market upon completion of the merger, subject to Thane's compliance with the minimum bid price requirements of $5.00 per share.

"Similar statements appear elsewhere." Pet. App. at 67a n.2.

In the section entitled "Summary of Proposed Merger," which appears at the beginning of the proxy statement-prospectus, petitioners made the following representations:

> The combined company is expected to meet the initial listing requirements of the NASDAQ National Market, which would provide the Reliant stockholders with greater liquidity than they have with Reliant common stock trading on the over-the-counter market.
>
> The Thane common stock to be issued in connection with the merger has been approved for quotation and trading on the NASDAQ National Market upon the completion of the merger, subject to Thane's

> compliance with the minimum bid price requirements of $5.00 per share.

Pet. App. at 67a.

The "Questions And Answers About The Merger" section of the proxy statement-prospectus, the purpose of which is to distill the most important aspects of the transaction and present them in plain English, also focused on NMS listing:

> Q: Will Reliant continue as a public company if the merger agreement is approved?
>
> A: No. Reliant will become a wholly-owned subsidiary of Thane upon the completion of the merger, and Reliant stockholders will become holders of Thane common stock. Thane has received approval for quotation and trading of its common stock on the NASDAQ National Market upon completion of the merger, subject to Thane's compliance with the minimum bid price requirements of $5.00 per share.

Pet. App. at 67a-68a.

Reliant stockholders were told the following under the heading "Reliant's Reasons for the Merger":

> The combined company is expected to meet the initial listing requirements of the NASDAQ National Market, which would provide the Reliant stockholders with greater

> liquidity than they have with Reliant common stock trading on the over-the-counter market.

Pet. App. at 68a.

Under the heading "Per Share Market Price Information," petitioners represented as follows:

> The Thane common stock to be issued in connection with the merger has been approved for quotation and trading on the NASDAQ National Market upon the completion of the merger, subject to Thane's compliance with the minimum bid price requirements of $5.00 per share.

Pet. App. at 5a.

Reliant stockholders were also provided a copy of the merger agreement as part of the proxy statement-prospectus. Section 6.5(b) of the merger agreement discusses listing under "Covenants of Thane":

> Thane shall use commercially reasonable efforts to cause its outstanding Thane Common Stock immediately after the Merger to be approved for quotation on the NASDAQ National Market System or, in Thane's reasonable discretion, another national securities exchange, subject to official notice of issuance, as promptly as practicable after the date hereof, and in any event prior to the Effective Time.

Pet. App. at 68a-69a. Thane was required, as a condition precedent to Reliant's obligation to consummate the merger, to have "'complied in all material respects with all covenants.'" Pet. App. at 69a. By letter dated April 9, 2002, prior to the merger closing, Thane was notified that its application to list its securities on the NMS was approved. In addition, Thane's stock also met the minimum $5.00 per share bid requirement, the only remaining condition precedent to listing. Nevertheless, "Thane's stock was never listed for trading on the NASDAQ National Market System." Pet. App. at 105a. There is nothing in the proxy statement-prospectus that even suggests that Thane reserved the right voluntarily to list on the OTCBB rather than the NMS.

Notwithstanding the representations set forth in the proxy statement-prospectus and quoted above, Thane's decision not to list on the NMS was concealed from Reliant's public stockholders prior to its merger with Thane. The decision not to list, however, was not concealed from Reliant's principal stockholders. Rather, that the parties (including the petitioners) attached great importance to the requirement to list on the NMS is evident by the fact that petitioners required Reliant and Reliant's principal stockholders to execute a written waiver of Thane's contractual obligation to list its shares on the NMS. Pet. App. at 87a n.10.

The Thane-Reliant merger was consummated on May 24, 2002, at which time Thane's stock began trading on the OTCBB. Pet. App. at 69a. Thane did not publicly explain the reason for its stock trading on the OTCBB, rather than the NMS, for approximately ten weeks thereafter. As described by the Ninth Circuit, Thane

stockholders "experienced a wild ride." Pet. App. at 7a. Finally, on August 14, 2002, Thane filed its Quarterly Report on SEC Form 10-Q for its quarter ended June 30, 2002, which, for the first time, publicly disclosed that petitioners intentionally opted not to list Thane's stock for trading on the NMS:

> In May and June of this year, we met with our investment bankers to discuss an underwritten public offering of our common stock. Our investment bankers advised us that we could potentially obtain more favorable pricing for the public offering if we implemented our move to the NASDAQ National Market in conjunction with the underwritten public offering. Over the course of June and July we have been preparing for the public offering, but we have recently concluded that present market conditions are no longer favorable for an underwritten public offering of common stock. As such, we are currently evaluating the listing of our common stock on a national market.

Pet. App. at 70a-71a. Remarkably, this more or less contemporaneous statement fails to even mention a pivotal April meeting which the district court found is the time when the decision not to list was made. Pet. App. at 65a-66a.

After Thane's stock's reported price quickly plunged from a high of $8.50 per share, petitioners took advantage of the bargain price of Thane's stock they

created by squeezing out the former Reliant public stockholders in a going-private transaction at $0.35 per share. Pet. App. at 71a.

REASONS FOR DENYING THE PETITION

I. THE PETITION IS PREMATURE

Inexplicably, petitioners are silent concerning the fact that they are asking this Court to exercise jurisdiction over a non-final order.[5] Petitioners can neither demonstrate extraordinary inconvenience nor present a fundamental issue worthy of review prior to the conclusion of these proceedings that would warrant this Court to depart from its long-standing policy of declining consideration of non-final orders. *See Hamilton-Brown Shoe Co. v. Wolf Bros. & Co.*, 240 U.S. 251, 258 (1916)(Lack of finality "itself alone furnished sufficient ground for the denial of the application."); *Office of Senator Mark Dayton v. Hanson*, 127 S. Ct. 2018, 2021 (2007) (Denying petition for certiorari where there are, *inter alia*, no "special circumstances that justify the exercise of . . . discretionary certiorari jurisdiction" of an interlocutory order.).

This Court has long declined the invitation to review interlocutory decisions. *See, e.g., Virginia Military Inst. v. United States*, 508 U.S. 946, 946 (1993) ("We generally

5. Petitioners' description of the Ninth Circuit's decision (Petition at 13) refers only to the reversal of the judgment in favor of petitioners and ignores the remand to address loss causation and other issues.

await final judgment in the lower courts before exercising our certiorari jurisdiction.") (Scalia, J., concurring); *Bhd. of Locomotive Firemen & Enginemen v. Bangor & Aroostook R.R. Co.*, 389 U.S. 327, 328 (1967)("[B]ecause the Court of Appeals remanded the case, it is not yet ripe for review by this Court.").

This Court is mindful that review of non-final orders can result in unnecessary delay, costs, and inconvenience. *Gillespie v. United States Steel Corp.*, 379 U.S. 148, 152-53 (1964). Petitioners have failed to demonstrate either "extraordinary inconvenience and embarrassment in the conduct of the cause," *Am. Constr. Co. v. Jacksonville T&K. W. Ry. Co.*, 148 U.S. 372, 384 (1893), or presented an issue that is "fundamental to the further conduct of the case," *United States v. Gen. Motors Corp.* , 323 U.S. 373, 377 (1945).

The Ninth Circuit's opinion reversing the district court's decision also remanded this action to the district court. The district court has yet to rule on damage issues or whether petitioners have met their burden of proving their affirmative defense of lack of loss causation. Any further delay only prejudices the respondents. Petitioners have already availed themselves of *en banc* consideration by the Ninth Circuit.

The Ninth Circuit's ruling on materiality cannot be said to constitute a ruling "fundamental to the further conduct of the case" insofar as the trial has been completed and the record closed. Only in circumstances where the issue sought to be reviewed by writ of certiorari affects the further conduct of the *trial* of issues necessary to the resolution of the merits of the

claims asserted in an action will the exercise of certiorari be warranted. *See Gillespie*, 379 U.S. at 153-54 (discussing cases granting writs of certiorari "where, as here, the case had not yet been fully tried"); *Gen. Motors*, 323 US. at 377 (granting certiorari where issue concerning offer of proof required clarification prior to further conduct of trial); *Larson v. Domestic & Foreign Commerce Corp.*, 337 U.S. 682, 685 (1949) (granting certiorari where issue would affect further trial proceedings); *Land v. Dollar*, 330 U.S. 731, 734 (1947) (granting certiorari where Court of Appeals reversed and remanded for trial).

As discussed herein, while respondents do not believe that the petition presents any compelling interests that would warrant consideration by this Court, the petition, in any event, is premature. Respondents submit that petitioners' failure to even attempt to substantiate the extraordinary relief of review of a non-final order should in and of itself be grounds for denial of the petition.

II. THE RELEVANT FACTS WERE NOT IN DISPUTE AND THE NINTH CIRCUIT APPLIED THE APPROPRIATE CLEAR ERROR STANDARD UNDER FED. R. CIV. P. 52(a)

Petitioners' contention that the Ninth Circuit failed to follow the requirements of Fed. R. Civ. P. 52(a) is premised on their suggestion that the Ninth Circuit dissembled when it articulated its standard of review. Petition at 5 and 25-26. Petitioners even advance a "gotcha moment." Petitioners think it telling that the Ninth Circuit's holding on materiality refers to

"the circumstances of this case." Petition at 26. As is clear from the district court's opinion, however, "the circumstances of this case" consist of undisputed evidence and the district court's error was not in its fact finding but in its application of the law to the undisputed facts.

Initially, the Ninth Circuit, relying on *Easley*, 532 U.S. at 242, held that after examining the documentary record, we have a "'definite and firm conviction that a mistake has been committed,'" and held that the statements in question were false and misleading.[6] The Ninth Circuit, on the issue of materiality, then held that the district court "erred when it considered the movement in share price of a stock that did not trade on an efficient market to determine materiality under the circumstances of this case." Pet. App. at 20a. It went on to hold that "[t]herefore, its conclusion that Thane International's misrepresentations were immaterial is clear error." *Id.* Stated another way, the Ninth Circuit corrected the district court's mistake of law and then discussed the undisputed evidence contained largely in SEC filings and written trial declarations that were submitted in advance of the bench trial and that supported its conclusion.

The district court's decision itself, makes it clear that the Ninth Circuit's reversal of the materiality prong

6. The petition does not seriously challenge this prong of the Ninth Circuit's holding. As set forth *supra*, the oral testimony could not have been of any aid to petitioners as petitioners required Reliant and its principal stockholders to waive NMS listing, thereby demonstrating their own belief that they had represented that Thane would list on the NMS. *See* Pet. App. at 87a n.10.

of the district court's decision was based on the application of correct legal principles to uncontested facts. The district court candidly stated that "without regard to price effects," it "would find that listing on the NMS is marginally material." Pet. App. at 86a. The district court went on to acknowledge that in considering the reported trading prices of a stock which clearly did not trade in an efficient market, "the Court admittedly proceeds into unchartered waters." Pet. App. at 89a. The Ninth Circuit emphasized the lack of factual issues by noting that "[e]ven accepting as true all of [petitioners' expert's] testimony, there is no factual dispute between the experts that [NMS] listing carries objective benefits that directly and positively affect corporate earnings, investor returns, and a stock's pool of potential shareholders." Pet. App. 25a.

While petitioners take issue with the Ninth Circuit's citation to *Bose Corp. v. Consumers Union of U.S., Inc.*, 466 U.S. 485 (1984), they do not (and cannot) point to any disputed evidence that forms the basis of the Ninth Circuit's holding. Instead, petitioners' entire argument on the perceived error under Fed. R. Civ. P. 52(a) is nothing more than a narration of cases that preceded and followed this Court's decision in *Easley*. *See* Petition at 16-22. The Ninth Circuit held unequivocally that the "clearly erroneous" standard applies to all factual findings and applied the most recent pronouncements of this Court. Pet. App. at 11a, 18a-19a, 20a, and 29a.

Petitioners' attempt to create disputed factual findings by the Ninth Circuit is unavailing. The Ninth Circuit's holding turned on the applicability of the efficient market theory in determining materiality, the

case law on which subject the district court consciously disregarded. It is not, as petitioners suggest, that the Ninth Circuit suddenly "favored" one expert over the other (Petition at 27) but rather that petitioners' expert, at petitioners' direction, disregarded binding *legal* precedent without presenting any contrary *factual* arguments. To the extent the Ninth Circuit credited plaintiffs' expert, that testimony, as well as the facts underlying it, were unrefuted. *See, e.g.*, Pet. App. at 27a ("Preston's uncontested testimony"). Again, it was the application of law to the uncontroverted facts which triggered the reversal of the district court. To support their argument that the Ninth Circuit's opinion conflicts with decisions of this Court and other Circuits, petitioners disregard the Ninth Circuit's unequivocal statement that it applied the Rule 52(a) "clear error" standard and do nothing short of accusing the Ninth Circuit of misrepresenting the nature of its own opinion. Petition at 16.

The supposed intra-circuit split in the Fifth Circuit is based on a strained reading of *McFarland v. T.E. Mercer Trucking Co.*, 781 F.2d 1146, 1148 (5th Cir. 1986). *McFarland* concluded that the district court's review of testimony (deposition) should be upheld unless clearly erroneous. *Id. Hall v. Nat'l Gypsum Co.*, 105 F.3d 225, 228 (5th Cir. 1997) also applied the clearly erroneous standard. So did the Ninth Circuit in *Thane*.

The litany of decisions cited by petitioners from the First, Fourth, and Ninth Circuits, concededly occurred in a variety of inapposite procedural contexts, and all

utilized the "clearly erroneous" standard.[7] Petition at 18-20. Petitioners' argument that there is some confusion in the application of Fed. R. Civ. P. 52(a) is based almost verbatim on the 1985 Advisory Committee Notes while at the same time giving short shrift to this Court's opinion in *Easley, supra*, decided long after the 1985 amendment to Rule 52(a). An examination of the underlying facts of these cases suggests that *Easley*, which was followed by the Ninth Circuit (Pet. App. at 19a), like the case at bar, involved primarily documentary and expert evidence, and credibility played a "minor role" (532 U.S. at 243). Petitioners attempt to distinguish *Easley* by claiming that it involved a "constitutional" issue, notwithstanding that *Easley* and the Ninth Circuit's decisions are consistent with Rule 52(a).

III. THE NINTH CIRCUIT APPLIED WELL-ESTABLISHED PRECEDENT REGARDING MARKET EFFICIENCY

A. The Circuit Precedents Are Uniform

The district court held that, "without regard to price effects," the representations concerning listing on the

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7. For example, petitioners' reliance on *Alexander Proudfoot Co. World Headquarters v. Thayer*, 877 F.2d 912, 916 (11th Cir. 1989) is baffling as the issue there was the propriety of a granting of a *dismissal motion* based on personal jurisdiction involving a *de novo* review of the complaint and affidavits. In *Padilla-Manqual v. Pavia Hosp.*, 516 F.3d 29 (1st Cir. 2008), the court reversed the dismissal for lack of jurisdiction and remanded for an evidentiary hearing to hear testimony to insure that a complaint was not dismissed without the opportunity to be heard. *Id.* at 34.

NMS would be "marginally material." Pet. App. at 86a. The district court candidly acknowledged that by relying solely on reported prices in an inefficient market to support a finding of immateriality, it was proceeding "into unchartered waters." Pet. App. at 89a. The district court also candidly acknowledged that it was not applying the reasoning of the seminal decision with regard to efficient markets, *Cammer*, *supra*, as it held that "[t]here is little doubt that Thane stock would not meet the tests for an efficient market under *Cammer*." Pet. App. at 90a n.11.

The district court asked: "can one even assess the price effect in Thane given that it did not trade in an efficient market?" Pet. App. at 88a. This is purely an issue of law. The district court answered the question in the affirmative without citing any authority in support of its decision to rely on Thane's reported market price exclusively. All analogous authority is to the contrary.

The issue of market efficiency typically arises in the context of a putative class seeking to avail itself of the "fraud-on-the-market" presumption of reliance in connection with class certification. In order to eliminate reliance as an individual issue in securities fraud actions, a putative class usually seeks to establish reliance based upon a security's reported trading prices, *i.e.*, the "market," contending that the conduct in question constitutes a fraud-on-the-market. A determination that reliance is an individual issue would preclude the necessary Fed. R. Civ. P. 23(b)(3) finding "that questions of law or fact common to the members of the class predominate over any questions affecting only individual members. . . ." *See Basic Inc. v. Levinson*, 485 U.S. 224,

242 (1988) ("Requiring proof of individualized reliance from each member of the proposed plaintiff class effectively would have prevented respondents from proceeding with a class action, since individual issues then would have overwhelmed the common ones.").

Quoting from a Third Circuit decision, this Court in *Basic Inc.* defined the fraud-on-the-market presumption as being "'based on the hypothesis that, in an open and developed securities market, the price of a company's stock is determined by the available material information regarding the company and its business. . . .'" 485 U.S. at 241. The most widely accepted test for determining whether there is an "open and developed" (*i.e.*, "efficient") securities market, is that articulated in *Cammer*. The *Cammer* court enumerated five factors as particularly relevant to determining whether the market for a particular stock is efficient: (1) the stock's average weekly trading volume; (2) the number of security analysts who follow the stock; (3) the existence of market makers and arbitrageurs active in the stock; (4) eligibility to file an SEC Form S-3 registration statement (eligibility for which is limited to large, well-known, and seasoned issuers); and (5) facts demonstrating a cause-and-effect relationship between unexpected corporate developments and an immediate stock price response. 711 F. Supp. at 1286-87. The Ninth Circuit, in *Binder v. Gillespie*, 184 F.3d 1059 (9th Cir. 1999), endorsed reliance on the *Cammer* factors, noting that they "are designed to help make the central determination of efficiency in a particular market." *Id.* at 1065.

Particularly relevant to this action is *Unger v. Amedisys Inc.*, 401 F.3d 316 (5th Cir. 2005), in which the Fifth Circuit analyzed, in considerable depth, the issue of market efficiency in the context of a stock which traded on the OTCBB and where plaintiffs were seeking the benefit of the fraud-on-the-market presumption of reliance. The Fifth Circuit held that "[w]ithout an initial demonstration of market efficiency, there is no assurance that the available material information concerning the stock translates into an effect on the market price and supports a classwide presumption of reliance." 401 F.3d at 322. Here, not only was there no "initial demonstration of market efficiency," there never was any demonstration of market efficiency as respondents' expert opined that the market was inefficient and petitioners' expert avoided making any assumption on whether Thane's stock traded in an efficient market in either of his two reports.

In performing its market efficiency analysis, the court below did not use the correct standard of market efficiency. The First Circuit's decision in *In re PolyMedica Corp. Sec. Litig.*, 432 F.3d 1 (1st Cir. 2005), contains a comprehensive analysis of the concept of market efficiency. The First Circuit defined an efficient market as "one in which the market price [of the stock] *fully reflects all* publicly available information." *Id.* at 12. (Emphasis in original). It rejected the lower court's definition which focused "on the general consideration by market professionals of *most* publicly announced material statements about companies." *Id.* (Emphasis in original.) Here, the district court did not even consider whether the price of Thane's stock reflected "*most* publicly announced material statements" (*id.* at 14;

emphasis in original); its analysis was limited to whether Thane's stock's price reflected one fact and one fact only – that it was not trading on the NMS.

On the same day as it issued its *PolyMedica* decision, the First Circuit applied the standard of market efficiency adopted in its decision in *PolyMedica* to its decision in *In re Xcelera.com Sec. Litig.*, 430 F.3d 503 (1st Cir. 2005). In affirming the district court, the First Circuit endorsed "the district court's reliance upon *Cammer* to determine whether the Xcelera market was efficient." *Id.* at 508.

The district court here acknowledged that "[t]here is little doubt that Thane stock could not meet the tests for an efficient market under *Cammer*." Pet. App. at 90a n.11. Nevertheless, the district court concluded "that Thane had the ability to impound the fact of non-listing fairly promptly." *Id.* Without reference to any authority, the district court "perceived" its duty in analyzing market efficiency at the trial stage to be less rigorous than a court examining market efficiency at the class certification stage. Pet. App. at 89a. The only explanation the district court gave was a reference to "sweeping due process consequences" of class certification. *Id.* It is counterintuitive to presume that the standard used by the trier of fact to determine materiality would be weaker than the standard used by a court determining whether a class should be certified at the initial stages of the litigation. Although the reason for ascertaining market efficiency here is different than in *Cammer*, *Binder*, *Unger*, *PolyMedica*, and *Xcelera*, the district court was dealing with the same market having the same mechanism for converting information into price. If the

market mechanism is found deficient in the context of a plaintiff seeking class certification, the same deficiencies should prevent a defendant from escaping the consequences of its misrepresentations because the reported prices in an inefficient market did not immediately drop.

The district court's approach to the issue of the relevance of the reported prices of Thane's stock is not typical. "When legal precedent is available, I follow it, not economic or academic literature." *In re PolyMedica Corp. Sec. Litig.*, 224 F.R.D. 27, 41 (D. Mass. 2004). The *PolyMedica* approach has the benefit of support in the precedent from this Court:

> We need not determine by adjudication what economists and social scientists have debated through the use of sophisticated statistical analysis and the application of economic theory. For purposes of accepting the presumption of reliance in this case, we need only believe that market professionals generally consider most publicly announced material statements about companies, thereby affecting stock market prices.

Basic Inc., 485 U.S. at 247 n.24. Here, there is no dispute that "market professionals" had little, if any, interest in Thane's stock. Thane's stock was not followed by any analysts or arbitrageurs, and there were few market makers. Pet. App. at 90a n.11. Although it may have been known that Thane was trading on the OTCBB shortly after the merger, there is no evidence that there were sufficient market mechanisms available to translate

that knowledge into price. The focus of *Cammer* and *Unger* is to identify such mechanisms (*e.g.*, volume, analyst following, multiple market makers, market capitalization, etc.) and verify their existence prior to relying on reported market prices. The district court chose to ignore the absence of these market mechanisms and thereby committed clear error by relying on the reported OTCBB prices generated in a demonstrably inefficient market.

B. There Is No Split Between The Second and Ninth Circuits Regarding The Use Of Price In Cases Where The Stock Is Inefficient

Petitioners' sole authority in support of its theory that a court could look to price in determining materiality in the absence of a finding of an efficient market for a stock is *Akerman v. Oryx Commc'ns, Inc.*, 609 F. Supp. 363 (S.D.N.Y. 1984), *aff'd*, 810 F.2d 336 (2d Cir. 1987), a case which was decided before the "efficient market theory" was explicated in *Cammer*, *supra*. The efficient market analysis of *Cammer* was endorsed by the Ninth Circuit in *Binder*, 184 F.3d at 1065, and explicitly rejected by the district court in its opinion resulting in the reversal. The district court candidly acknowledged by not following *Cammer* and *Binder*, it "proceeds into unchartered waters." Pet. App. at 89a. Inexplicably, petitioners do no bother to cite to *Cammer* or *Binder* in their petition.

The efficient market theory explicated in *Cammer* is likewise the standard in the Second Circuit as evidenced by numerous decisions decided after *Akerman*. Any alleged split in the Circuits is thus

illusory. In *In re Initial Public Offerings Sec. Litig.*, 471 F.3d 24, 42 (2d Cir. 2006), the Second Circuit relied on the Sixth Circuit's analysis of market efficiency in *Freeman v. Laventhol & Horwath*, 915 F.2d 193, 199 (6th Cir. 1990), which is premised on *Cammer*. *See also In re SCOR Holding (Switzerland) AG Litig.*, 537 F. Supp. 2d 556, 574 n.24 (S.D.N.Y. 2008) (relying on the *Cammer* factors to determine whether the market for shares was efficient).

Significantly, in *Akerman*, there is no discussion of the efficient market hypothesis and materiality and efficiency essentially were presumed.[8] 810 F.2d at 341. Implicit in the Second Circuit's acknowledgment that the price of the stock rose in reaction to the disclosure of the misstatement was the reliance on the propriety of the stock price. *Akerman*, 810 F.2d at 343. In *Akerman*, both plaintiffs and defendants relied on the price of the stock and the district court noted that the case was "far from one of monumental significance." 609 F. Supp. at 366. The only relevance *Akerman* has to the case at bar is the Second Circuit's refusal to take jurisdiction over interlocutory issues. 810 F.2d at 339-40.

C. The Ninth Circuit's Decision Followed This Court's Precedents

The Ninth Circuit's decision is also consistent with this Court's holdings in *TSC Indus., Inc. v. Northway,*

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8. There is a stray reference by plaintiffs to "the thin market" for the subject stock which reference was found to be "internal[ly] inconsisten[t]" with other positions of plaintiffs. 810 F.2d at 343.

Inc., 426 U.S. 438, 449 (1976), *Basic*, and *Affiliated Ute Citizens v. United States*, 406 U.S. 128 (1973). *TSC*, sets forth an objective standard for materiality of omissions or misstatements for all Federal securities law purposes: "An omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote." *TSC*, 426 U.S. at 449. The standard contemplates:

> a showing of a substantial likelihood that, under all circumstances, the omitted fact would have assumed actual significance in the deliberations of the reasonable shareholder. Put another way, there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the "total mix" of information made available.

Id. Accord Basic, 485 U.S. at 231-32.

The Ninth Circuit's analysis of materiality took into account undisputed facts, accepted as true all of petitioners' expert's testimony (Pet. App. at 25a), and only disagreed with the district court on the issue of the legal consequences of the lack of an efficient market. In *Affiliated Ute*, 406 U.S. at 152-53, this Court ignored the share price holding that the district court "is not restricted to actual sales prices in a market so isolated and so thin as this one." *Id.* at 155. This is precisely what the market for Thane was – isolated and thin.

D. The Ninth Circuit's Opinion Is Well Reasoned

The Ninth Circuit's opinion also is consistent with both modern finance theory and common sense. Petitioners represented that listing on the NMS would increase the liquidity of Thane's stock.[9] One of the main reasons for this is that most institutional investors cannot trade in stocks listed only on the OTCBB. Pet. App. at 27a. It is Economics 101 that a decrease in demand – 48.3% of all equities were owned by institutional investors in 2001 (*id.*) – *i.e.*, lowering the demand curve, results in a lower price.

The concept of different degrees of efficiency presumes the existence of an efficient market that meets the threshold standards of *Cammer*. The very case cited by petitioners supports this proposition. Petitioners cite *Eckstein v. Balcor Film Invs.*, 8 F.3d 1121, 1130 (7th Cir. 1993), for the proposition that "'[e]fficiency' is not an all-or-nothing phenomenon." Yet, the issue in *Eckstein* was whether the market for the partnership units at issue was "efficient." *Id.* The court considered, *inter alia*, that there were no market makers and the units were thinly traded. The *Eckstein* court in effect rejected the "fraud-created-the-market theory" as a substitute for reliance based on the specific circumstances of that case. *Id.*

In order to entice this Court to exercise jurisdiction over the petition, petitioners claim an alleged split in

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9. As the Ninth Circuit pointedly noted, mere "approval [of listing] alone would do absolutely nothing to increase a stock's liquidity." Pet. App. at 15a.

the Circuits concerning the relationship between price and materiality in efficient markets. Petition at 34-35. Again, petitioners simply disregard "the undisputed fact that the newly merged Thane International never did trade on an efficient market." Pet. App. at 29a. Any argument relating to consideration of movements in price in an efficient stock is irrelevant here and not appropriate for review as it is uncontroverted that Thane stock did not trade in an efficient market. Further, petitioners fail to articulate any error committed by the Ninth Circuit in this regard and simply provide a narrative of other circuits' analysis of price in determining materiality.

Seemingly, the issue raised by petitioners is one of timing, *i.e.*, what is the appropriate time within which a stock price must move in reaction to news for it to impact materiality. Implicit in each of the decisions cited by petitioners is the existence or presumption of an efficient market. Interestingly, if one looks beyond the snippets of quoted material and delves into the facts in *In re Burlington Coat Factory Sec. Litig.*, 114 F.3d 1410, 1425 (3d Cir. 1997), there was no real issue on how long it took the stock price to react to the disclosure of negative news; it never reacted. The *Burlington* plaintiffs asserted that the stock was efficient and the disclosures at issue had no effect on the company's stock price. In decisions following *Burlington*, the Third Circuit has made it clear that lack of materiality based on price is predicated on an "efficient market." *See, e.g., In re NAHC, Inc. Sec. Litig.*, 306 F.3d 1314, 1330 (3d Cir. 2002).

The distinction noted by petitioners regarding the Fifth Circuit limiting the effect of price in an efficient market to determine reliance and not materiality is irrelevant here as reliance is not an issue. *See Nathenson v. Zonagen, Inc.*, 267 F.3d 400, 415 (5th Cir. 2001).

Finally, the First Circuit's decision in *PolyMedica*, 432 F.3d at 7, defines "efficiency" as the "flow of information in the relevant market and effect of that information on the price of the stock." *PolyMedica* held that an efficient market is "one in which the market price of the stock *fully reflects all* publicly available information." 432 F.3d at 14 (emphasis in original). It has never been alleged even by respondents that the market for Thane stock could reflect "all public information."

Ironically, the Ninth Circuit's view of the efficient market theory is fully consistent with that of petitioners' expert, albeit in testimony in another case. In a Delaware action in which petitioners' expert acted as a trial expert, he ignored the reported trading price of a stock trading on the New York Stock Exchange, which otherwise lacked indicia of efficiency, and opined that it was fair for the expert's client to force a public company that such client controlled to pay $17.75 per share for a stock the reported trading price of which was only $3.70 per share. The district court characterized this testimony as opining that the trading price reported on the New York Stock Exchange "is irrelevant" but failed to apply the same logic to this case. Pet. App. at 86a n.8.

E. The Ninth Circuit's Opinion Will Not Likely Have Any Effect On The Legitimacy Of Bench Trials

Petitioners' argument that the Ninth Circuit's opinion would adversely affect bench trials is both irrelevant and not based on sound legal or empirical data. It is doubtful whether any of the statistical data available would be applicable to securities cases where in recent years there have been only a handful of cases that went to trial. Here, it was petitioners who demanded the commonly believed more defendant-friendly bench trial. Petition at 10. Recent studies have noted the overall decline of civil trials[10] as well as the possible existence of an anti-plaintiff bias at the federal appellate level.[11] In addition, studies have shown higher reversal rates for verdicts reached by juries. *See, e.g.*, Theodore Eisenberg & Michael Heise, *Plaintiphobia in State Courts? An Empirical Study of State Court Trials on Appeal*, Cornell Legal Studies Research Paper No. 07-006, at 3 (Sept. 2007). Suffice it to say, the data offered by petitioners is selective.

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10. Marc Galanter, *A World Without Trials?*, 2006 J. Disp. Resol. 7, at 2.

11. Kevin M. Clermont & Theodore Eisenberg, *Anti-Plaintiff Bias in Federal Appellate Courts*, 84 Judicature 128 (2000).

CONCLUSION

For all the foregoing reasons, respondents respectfully request that the petition be denied.

Respectfully submitted,

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